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**Approaches And Mechanisms For Developing
Small-Scale Food Processing Industries**

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APPROACHES & MECHANISMS FOR DEVELOPING SMALL-SCALE FOOD PROCESSING INDUSTRIES

By Ravi Awasthi

I. INTRODUCTION

In the first flush of their desire to industrialise and catch up with the industrialised West, many developing countries launched strategies and adopted policies which favoured large-scale and capital intensive industries. This climate of opinion may now be said to have undergone a sea change. While the relevance and importance of large-scale industries, where economies of scale are of greatest economic significance, are recognised and must continue to be emphasised, it is now accepted that small-scale industries have a very significant role to play in the economic development of these countries.

This acceptance of the role of small-scale industries in the planned economic development of the third world arises from the recognition that labour intensive small-scale industry development can play a significant part in making a dent in solving the problem of unemployment. It overcomes to some extent, too, the universal problem of shortage of capital and foreign exchange endemic in the third world. The possibility of dispersal of small-scale units in rural, semi-urban and urban areas seems also to afford a chance that problems of regional balance and over-crowding in urban areas may be more amenable to solution if a policy of planned small-scale development is made an integral part of the development process.

While it is true that this acceptance has made the task of promotion of small-scale industries somewhat easier than before, it is far from the case that the battle has been won. It is still true that the basic infrastructure that is essential for their promotion has not been put into place in many of the developing countries.

In this paper, after discussing the available approaches and recognised strategies for the development of small-scale food processing industries, a twofold task has been undertaken. In the first part I address myself to the would be entrepreneurs who would like to go into production on a small-scale because the resources they command or hope to command are small. Here the main thrust of my argument is to highlight all the possible pitfalls that can destroy an entrepreneurs' dream and land him into bankruptcy and ruin.

In the second part I have given an outline of the various institutional and policy mechanisms that India has developed over the years to ensure that small-scale food industries can play their role effectively and efficiently. It is my hope that this will be found useful by those whose job it is to promote small-scale industries in Malaysia.

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2. APPROACHES AND STRATEGIES

Small scale food processing industries can play a key role in the industrialisation of most developing countries. It has been established that they generally use more labour in relation to capital than large industries. They can be established rather quickly, require shorter gestation period and need smaller markets to be economical. They stimulate the growth of industrial entrepreneurship and promote a more de-centralised pattern of ownership and location. They can raise capital more easily and provide a reduction of financial risk through diversification.

Small scale operations are appropriately suited to a wide variety of projects especially connected with food. They enable optimum utilisation of necessary inputs as determined by local conditions of supply and demand and produce goods at a rate and of a quality appropriate to market requirements.

A wide range of food products can be manufactured in the small-scale sector. The technologies are simple. The technicians can be quickly trained to operate the machines. The projects can be set up even in rural areas with basic infrastructure.

There seems now a greater appreciation, in Malaysia, of the important role that small industries can play in its economic and industrial development. These industries have also been accorded priority in Malaysia's Industrial Master Plan (1986-1995). With a view to further provide impetus to the growth of bumiputra-based small scale food processing industries in rural areas, as envisaged in the New Economic Policy (1971), the Nursery Factory Scheme is a novel action oriented development.

While the need for action to promote bumiputra based industrial development has been well recognised, one of the major constraints in accelerating the industrialisation process is the difficulty the 'scheme' faces in the search for technology and industrial know-how. Other equally difficult areas are finance, marketing (and export), supply of raw materials, technical training, selection of right type of machinery and equipment, linkage with large scale industries (sub-contracting), etc.

2.I Development of Small scale food processing industry: modus operandi

How a developing country like Malaysia is to develop its small scale food processing industrial sector is of course a decision to be taken by the government and concerned institutions in the context of its endowment of natural and human resources and its economic and social objectives. Policy measures to encourage technological choices have to be adopted. Promotion of appropriate technology in the food industries can be viewed as one element in the industrialisation strategy. The removal of existing bias in favour of 'turnkey' technology and large scale industries in tariff policy, banking and financial practices, and vocational training are but a few areas to look into.

2.I.I Industrial Policies:

Processing industries based on agriculture and fisheries are central points in the economics of many developing countries. In the process of industrialisation due attention should be given to the small scale enterprises. In a number of countries food processing activities are very often carried on in small-scale enterprises. Actually, food processing of almost all kinds can make a significant contribution to employment and income generation. Close to their raw material supplies of agricultural produce, food processing activities can also augment supplies of processed food in such areas. This can also slow the migration of distressed and jobless people to the towns. A policy of growth and continued self reliance will promote small-scale rather than large scale food processing. Such policies include greater emphasis by the banking system on smaller industrial loans, which should be supported by extension services.

In many developing countries large scale enterprises tend to benefit from the customary framework of import substituting industrialisation, with easy access to large bank loans at rather low rates of interest, the duty-free importation of machinery, unimpeded access to foreign technology, and often a monopoly in the domestic market. This sort of environment for industrial growth is as likely to retard the growth of small firms as it is to strengthen the position of large ones. Modern machinery is implicitly given preference over technologies more appropriate to the human resource endowment and the needs of the people for basic products. It is quite common that large modern food factories displace existing small-scale food processing units and thus diminish the over-all level

of employment. Till now the large modern food processing factory has had every financial incentive and preference in many developing countries. Now the current should flow strongly the other way, in favour of small factories.

2.1.2 Appropriate technology:

A technological search and appraisal unit or cell for food processing industries under the Ministry of Trade and Industry can play an important role. Such a unit could examine and evaluate the appropriateness of the project, the product and the proposed technology to provide information on alternative technologies and would make positive and specific suggestions to serve the broad economic and social objectives, with a view to developing small-scale food processing enterprises where advisable.

2.1.3 Science and Technology:

The government encourages or gets involved in greater extent in generating new relevant technologies suitable for small scale food processing factories or in adapting the existing ones in other developing countries to the real needs of the country. A few examples of locally developed food-processing technologies with considerable potential are:

- Sugar confectionery
- Open-pan sugar plants
- Biscuits and Bread production
- Gari production from Cassava
- Hammer mills for flour
- Pastas production
- Edible oils expelling
- Animal and poultry feed mixing
- Fish meal
- Rice mills
- Fruit & vegetable preservation
- Ice candy
- Meat products
- Milk and Dairy products
- Chewing gum
- Carbonated beverages
- Alcoholic beverages
- Spices, etc.

In the generation and adaptation of technology, the growth of domestic capital goods sector, establishment of local and regional research institutions and the reorientation and strengthening of education and training programmes play highly significant and positive roles. In certain countries research institutions do exist but they have few links with local industry; it may, therefore, be necessary to reorient them in the appropriate direction.

The above discussions have so far emphasised for setting up strong governmental strategy for technology search and appraisal, to constantly keep in touch with technological developments and the sources of supply of appropriate and relevant technologies. The new direction of the country must be towards cheaper products, more labour - intensive techniques, smaller and more dispersed plants, and better use of indigenous materials and capital goods industry.

2.2 Characteristics of food processing industries:

For the development of small-scale food processing industries one must take into account various aspects of production, the handling of raw materials and certain social factors. Processing plants can never operate effectively unless full participation of the primary producers in the entire chain of operations is ensured, from raw material production to the processing plant. There is a need to coordinate raw material planning owing to their perishable nature. Most of the raw materials are produced in areas with a predominating rural population. The successful development of processing industries demands close relationship between the primary producers and the processing plant. In many developing countries such relationship does not exist or is poorly developed hence Government should concern itself more actively with this problem. Production methods and processes need adaptation to meet specific requirements of industrial processing; for example:

Food processing, particularly canning, is expanding in many countries; a processing plant requires readily available raw materials. An adequate supply at a reasonable price and reliable deliveries can hardly be assured under the conditions of agricultural production prevailing in many developing countries. Variation in yield owing to poor quality seed, unfavourable weather, diseases and so on often restrict the availability of fresh produce. To be sure of his supply, the processor should be in a position to contract with farmers or be permitted to acquire land on which he can grow produce specifically required for processing.

Modern food processors are not prepared to accept whatever raw material is offered by the farmer. To accelerate the development of food processing industries the primary producer should be given guidance. Technical services and facilities for small scale food industries should be created.

Incentives should be given, for instance, guarantees for the continuous delivery of raw materials to the industry at reasonable prices. This may in turn depend on the availability of adequate facilities for storage, processing, packaging and distribution. These lack in many developing countries, and, as a result, the percentage of waste and losses, especially in the perishable food sector, is very high.

2.3 Supporting and related industries including utilization of waste material:

The establishment of food processing industries invariably leads to the development of supporting and related types of industries. Equipment and machinery for handling, processing, storing, packaging and a great variety of other products should be manufactured for use in the processing industry. Local workshops should be set up for repair and maintenance.

Industrial development, especially in rural areas, also requires adequate supplies of water and electricity; housing and roads; suitable transport facilities including refrigerated transport for perishable food; improved farm services and market structures; co-operatives and credit systems; and greater managerial competence. The role co-operatives can play in the development of small-scale food processing industries can not be stressed strongly enough.

2.3.I A few examples may be given to show how such supporting and related industries may be established.

- A slaughter-house always produces some waste such as condemned meat, hooves, claws, intestines, blood, bones and other offal, the disposal of which is often a serious problem. Consideration should, therefore, be given to the utilization of waste and by-products. If these are available in sufficient quantity, a small dehydrator or disintegrator, either to manufacture bone, blood or meat meals separately, or to make a mixture, which, in turn, can be used as chicken feed.
- Processed oil-bearing fruits or seeds leave as residue a presscake containing some oil, all the rest of the fruit or seed being mostly of fibrous nature. Every effort should be made to have these presscakes used in the immediate area of the oil expeller, or to see how other or by-products could be added to set up a feed-mix plant. Converted animal offal from neighbouring slaughter house, bran from rice mills

or from a pineapple-canning plant, or other dried residues of vegetable origin can then be combined, so that there is little or no loss.

- The principal material obtained from coconut is edible oil. There are also valuable by-products - coir, fibre and kernel meal or flour. The coir can be converted into yarn which in turn may be spun into ropes, plaited or woven into carpets. The fibre is used to make brushes, and ground kernel can be used as a filler in plastic production. Similarly the fibre extracted from the leaves of the pineapple can be made into a fine cloth.

2.4. The Plant:

For a number of food industries elaborate plants are not required, and indeed are not advisable. Some machinery fabricators today also produce such equipment and machinery that are suitable for small-scale processing plants.

It is necessary to determine the viability of the processing unit. This requires somewhat detailed project identification, which will greatly differ with respect to the raw material to be processed. The viability determination will be a part of the Project Report as described under para 3.3. To reduce risk as far as possible, expert advice will often be necessary in selecting the equipment and machinery and the technological process.

It is economical and often technologically necessary to establish a food processing industry close to the source of the raw material, specially when infrastructure is under developed. Through a small sized food processing plant, in the initial stages of development, modern but appropriate technologies can be demonstrated; experience gained in the handling of raw materials and in the production processing, packaging, distribution and marketing of the end product; the required contact established between farmer and processor; in-plant training provided for technical and managerial personnel; and a favourable investment climate created, which will make it possible to set up local farmers' co-operatives and credit unions. Once experience has been gained in managing and operating the first or say pilot plant successfully, duplication or enlargement of such plants is relatively easy.

Other essential steps would be to improve transport including refrigerated transport, cold storage, marketing and distribution facilities. Establishment of a practical quality control laboratory either in the plant or as a part of 'common-service-facility' is important for developing and maintaining standards subject to continuous review and improvement.

So far this paper has attempted to show that the small-scale food processing industry can be a permanent feature of the industrial scene in a developing country; that it is able to adjust itself to ever changing conditions and to seize opportunities as they arise; that it offers great scope for specialised operations and customer service; that it can and should be appropriate yet modern.

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3. MECHANISMS

3.1 Introduction

The small-scale food industries (SSIs) sector, in many developing countries such as Republic of Korea, Taiwan province of China and India, has been a dynamic one with a large group of motivated people who have forged their enthusiasm and skills, faced odds with grit and determination and have proven their capabilities to themselves and the world. It is now hoped that this can be repeated in Malaysia too.

The following 'brief' is meant for you - the new entrepreneurs - who have decided boldly to enter this challenging sector, to be on your own, to provide employment to few others and in the process to contribute to the nation's industrial progress.

The quickness with which an enterprise establishes itself and matures to success is directly proportional to the intellectual effort that precedes it; having a careful feasibility analysis and a planned project approach positively help to overcome future pitfalls.

This chapter hopes to help you in this process; to give you broad guidelines on time tested approaches in setting up your unit and the incentives and special facilities which may be, rather should be, offered by banks, financial institutions and the government to the small-scale food industries in Malaysia.

PART ONE

3.2 What project should I have?

3.2.1 Project ideas could originate from various sources or due to different reasons like the success story of a friend/relative, experience of others in manufacture/sale of product, demand for certain products, chances of producing a substitute of an article imported for which there is good demand etc., and of course the motivation, background and skill of the entrepreneur and his associates.

3.2.2 One major aspect while choosing a project idea should be to ascertain the extent of the marketability of the product proposed to be manufactured, its general use, industries which use it, its end use and its buyers. You should, therefore, study the demand and supply of the product over

the last few years to estimate its future demand based on the past trend. While doing so it would be necessary to take into consideration the anticipated changes in food habits, technology and levels of incomes of the people. If the product proposed to be manufactured has market throughout the country, the study should take into account the demand and supply of the product for the whole country. However, if the market for the product would be confined to one/two states/or a particular region the study may be confined to the concerned states/region. Many units function as ancillaries to major industries. In such case, their fortunes being very closely dependent and linked to that of the 'parent unit', it is very important that detailed analysis are made on various areas before the decision to become an ancillary is made; i.e. areas like, will the unit be totally dependent on the parent unit? the potential for reasonable profit and future growth, the experience of similar ancillary units, whether there are any problems in obtaining payments or supportive know-how, whether the investment in fixed assets will be such as to facilitate easy branching off into a new product line in case the ancillary arrangement does not yield anticipated benefits etc.

An import-substitute product, basically, should have a good market in view of the general policy to encourage indigenous production. It would, however, be necessary to have a clear idea of the governments' import policy, present demand, the landed price of the imported item and how your price will compare with it, quality difference, etc.

- 3.2.3 In order to arrive at reasonable estimates of the future demand and supply for a product, information relating to the capacity of existing units manufacturing that product, the extent of their utilisation, the capacity of the units that have already been granted licences but are in the process of being established, import and export potentiality of the product etc. should be taken into consideration.
- 3.2.4 A SSI unit generally enters the market which is localised and already has existing manufacturers. The success of the new unit in competing with the existing manufacturers would depend on a combination of its capability to identify and approach its targeted customer group and its marketing features like price, quality, delivery schedules, sales promotion etc.

3.3 Project Report

3.3.1 Preparation of a Project Report:

- a) Many entrepreneurs, despite their enthusiasm and skills, overlook planning aspect which at times, becomes a major weakness. In this connection it would be extremely useful if you sat down and wrote all necessary details relating to your project and its components, after identifying the product you propose to manufacture and its market potential.

- b) If necessary, the assistance of experts from Bank Pembangunan Malaysia Berhad (BPMB), Small Enterprise Division (SED) of the Ministry of Trade and Industry, Malaysian Agricultural Research and Development Institute (MARDI), Standards and Industrial Research Institute of Malaysia (SIRIM), Forestry Research Institute of Malaysia (FRIM) and other available consultancy houses may be used for the purpose. The report should establish the technical and economic feasibility of the project and its growth plans.

3.3.2 Technical Feasibility:

Although under the 'Nursery Factory Scheme', the location, land and buildings are already predetermined and provided for, but if you were to grow out of the scheme, or plan establishing the project on your own you should keep the following in mind:

- a) Location: You should select the location for the unit taking into consideration the proximity of source of raw material, skilled labour, market and other infrastructural facility. Perhaps the government may announce certain incentives for promoting industrial units in backward areas.

- b) Land and Building: Factory buildings can be either rented or owned. Investment in land and building is better avoided in the initial stages to avoid the locking up of funds. It is advisable to go for industrial sheds in developed areas or industrial estates on rent/lease. If the factory building is proposed to be constructed, you should ensure that the land is free from encumbrances and it can be used for industrial purposes; if not, the competent authority should be approached for this purpose. While constructing the factory building, you should ensure that adequate provision is made for

the future requirements. There may be certain licences and clearances required to be obtained under law before a unit can be established, like registration certificates, no objection certificates for having industrial sheds in specified areas (metropolitan area/agricultural area, etc.). It would be advisable to get in touch with local authorities and obtain the licences/clearances. While deciding upon the size of factory buildings, adequate provision must be made for future expansion.

- c) Manufacturing Process: You will have to decide on the manufacturing process to be adopted - whether it is based on the existing technology or new technology and whether the latter is indigenous or the know-how has to be imported. If you are new entrepreneur, it is better that tested technologies are used. While adopting new/imported technology, the position relating to copyright/royalty, etc. should be verified.

3.3.3 Machinery and Equipment

- a) You should properly assess the requirements of machinery/equipment, spare parts, tools etc and decide upon the proper size of the plant and machinery and its usefulness for the purpose it is bought for. You should remember that once fixed assets are acquired, it would be very difficult to change them. Careful thought should, therefore, be given before deciding upon them. The machinery items should be necessary and adequate, with no flamboyant investment. Sometimes other units in the neighbourhood may have idle machine capacity which can be used by you for some of your operations, thus avoiding additional investment in machinery. Likewise it is sometimes cheaper and convenient to have some components bought out instead of buying fresh equipment and making them on your own. These points may be kept in mind while deciding on investment in plant and equipment.
- b) To have some idea of costs and quality on your own, the names of various suppliers or manufacturers of the required machinery may be ascertained and quotations obtained. You should decide whether the required machinery is to be bought directly or on hire-purchase basis on which BPKB may like to help. However, if any items of machinery are to be imported, you should apply for import licence, if the import of those items of machinery is allowed under the

Government's import policy. While selecting the plant and machinery you must ensure that the same has minimum breakdowns and spare parts requirements.

- c) Plant capacity: You will have to decide on the plant capacity taking into consideration the existing market, the future needs, minimum cost of production and the break-even capacity of the plant.
- d) Plant layout: The layout of the plant should be such as to aim at:
 - i) Optimum output,
 - ii) Safety measures,
 - iii) Making production control and supervision easy,
 - iv) Reduce travel distance of men and material in process.

3.3.4 Raw Material

- a) You should ensure that the type of raw material required will generally be available in the quantities desired at fair prices and when wanted.
- b) Where any items of raw materials, chemicals and additives and packing materials are to be imported, you should ascertain whether under the Government's import policy those could be imported.

3.3.5 Utilities

You should ensure that the following utilities/services are available adequately:

- a) Power
- b) Water of good quality
- c) Disposal of waste and effluent.

3.3.6 Manpower needs:

You should determine the manpower needs on the basis of the total project. The requirement and availability of the skilled, semi-skilled and unskilled labour and managerial personnel should be properly assessed. While the unskilled labour may be available everywhere, skilled labour is not available easily and may have to be procured from nearby places, which is costlier, or trained, which is time consuming.

3.3.7 Economic Feasibility

- a) **Marketing:** You should have a clear idea regarding the size of the market for the product in the region proposed to be covered, likely growth of market, the customers, major competitors in the field, their price, quality of their product and their marketing strategies. After analysing these factors, you should develop a suitable marketing strategy, covering the product mix, price, quality and the sales promotion methods.
- b) **Financial Projections:** You should make projections for profitability over a period of time. Profitability of a unit depends upon the cost of the project, finances thereof, cost of operations and sales revenue. The break-even point is that quantum of sales at which a unit is just able to recover all expenses, i.e., it neither earns a profit nor incurs a loss.
- c) **Working Capital:** The working capital requirements may be computed taking into account the following:
 - i) The minimum stocking period for raw materials, finished goods and stores taking into account the availability of raw materials, the lead time required in obtaining them, advance to be paid to suppliers, quantum required for ensuring continuous production, off-take schedule of customer requirements and the average value of stock-in-process.
 - ii) Percentage of credit sales to total sales, the average period taken for bills to be realised.
 - iii) Advances received from customers and credit in purchases.
- d) The total cost of the project can be computed as under:
 - i) The cost of fixed assets proposed to be acquired.
 - ii) Total working capital requirements (for the first year of production)
 - iii) Preliminary and pre-operative expenses. Provision should be made for escalation of costs.
- e) Following are the sources for meeting the above costs of the project:
 - i) Your own capital; seed capital assistance from State Government/ authority.

ii) Loans/deposits from your friends/relatives, which can be held for long periods, say three years.

iii) Medium term loans (for fixed assets) from the banks/term lending institutions.

iv) Working capital loan from the commercial bank.

v) Credit on purchases.

vi) BPMB bill discounting for purchase of machinery on deferred payment guarantee.

3.3.8 Organisation

The project report should include a write up on the organisation set-up in your unit and the methods proposed for monitoring performance.

3.4 Some important features to be observed in running a small-scale food industry:

3.4.1 The planning in key areas like sales, production, and finance plays a very vital role. You should, therefore, draw an annual plan right in the beginning to include:

- i) Sales plan: indicating the volume of sales expected with product-wise break-up.
- ii) Production plan: based on the sales plan. This would also give an indication of the capacity utilised.
- iii) Purchase plan: not only to ensure smooth flow of materials required but also to give you an idea of cost of materials.
- iv) Expense budget: to take into account wages to the labour, rent of premises, administration costs, selling and distribution expenses and other overheads.
- v) Profit plan: based on the level of sales expected to be achieved in the year.

3.4.2 Such an annual plan will help you in identifying the area(s) where things can go wrong; whether there is a need to recast the plan completely or it needs a slight modification.

3.4.3 It is necessary that the unit is geared to generate internal surplus at

the earliest so that the equity base is strengthened. For your unit to run on profitable level and generate internal surplus efficiently, it is necessary to handle the problems detailed below.

3.5 The common problems and pitfalls seen in SSI units are:

3.5.1 Production

- i) Not having a fully-developed product or project idea at the start of operations resulting in idle production capacity and depletion of funds even before going in for commercial production.
- ii) Poor material planning resulting in under utilisation of capacity as also, shortage of working capital. It is important that the right material is bought at the right time and in the right quantity.
- iii) Lack of production planning and control leading to inefficient utilisation of labour, machines and raw materials resulting in lower profitability. If proper control is not exercised over production, the delivery schedule might not be met.
- iv) Break-down of plant and machinery resulting not only in costly repairs but also in holding up of production.
- v) Lack of quality control, harming the units' reputation. If the goods are sub-standard, these may have to be withdrawn and reprocessed or these may be totally scrapped. In either case, there will be loss of money and materials.

3.5.2 Marketing

- i) Inadequate assessment of demand for the product and the time it would take to build up a market. You should not go by hearsay in these respects but should study the features of competition in the market and plan the production accordingly.
- ii) A poor quality product - Do not sacrifice on the quality as having bought the product and found it unsatisfactory, no one would purchase it again.
- iii) Booking large orders at fixed prices in an inflationary market should be avoided; a price escalation clause may be inserted in the order form.

iv) Avoid sole dependence on one or few buyers for the product.

v) Poor marketing strategy: you should study the marketing strategy adopted by others in the same field to improve upon certain aspects to gain an edge over them.

3.5.3 Finance

i) Lack of financial planning: you should work out the amount of funds needed for acquiring fixed assets for the level of operations planned and decide upon the sources from which these funds would come. You should ensure that the level of production and sales you have planned is above the break-even point because otherwise your unit would be incurring losses.

ii) Absence of proper accounting system: in the absence of proper accounting or information system you would not know how your unit is faring. You should remember that it is more expensive in the long run not to have a proper accounting system. The accounting system followed should be such as would provide all financial information whenever required.

iii) Diversion of funds into unproductive uses: funds for development or expansion must come out of equity and funds should not be drawn for non-productive uses. Further do not use working capital funds for investment in plant and machinery which should be purchased either out of internally generated surplus or from long term finance.

iv) Poor management of working capital: e.g. carrying excess inventory, tardy collection of bills, lack of expense control. You should control expenses according to the level of production by means of an expense budget. There should be a regular follow-up on collection of bills to ensure that the bills are paid in time and the money is put back into the business to keep it running smoothly. You should also ensure that payments to creditors are made according to schedule as otherwise goods may not be received from them in future and the production may suffer.

3.5.4 Some other pitfalls you should avoid are:

i) New product development or diversification: do not fritter away internally generated surplus into new products at the cost of existing ones. Do not divert working capital towards development expenses.

ii) Lack of proper organisation: if you do not allocate people to specific jobs and tell them to whom they should report, it would neither be possible to trace failures in operations nor rectify them. To function effectively you must have an organisation of the right size and manned by the right people.

iii) Poor industrial relations: unhealthy working conditions, poor wages, no incentives for better production and not looking after workers' safety could lead to industrial unrest and low productivity. If you look after the workers interest, they would certainly look after your unit's interest.

PART TWO

3.6 Incentives and Institutional Support

3.6.1 The strategic role of small scale food processing industries in the overall economic development of a number of developing countries, such as India and Malaysia, has been emphatically recognised in their national policies and reflected in their five year plans. With a view to ensuring adequate flow of funds, the small scale food industries sector is normally recognised as a priority sector. Perhaps it would be a good idea to see what has been done to successfully develop small scale food industries in some other developing countries. To my mind, India is one country in Asia where the small scale sector has continued to play a vital role in the fulfilment of its socio-economic objectives. I, therefore, would like to discuss the facilities offered and mechanism adopted there; all or some of which might be found useful for adaptation in Malaysia too.

3.6.2 Definition

Small Scale Food Industries in India have been defined as industrial units engaged in manufacturing/processing/preservation activities with original investment in plant and machinery not exceeding US\$ 300,000. A few years ago a small scale industry was one which would employ less than 50 paid full time employees.

3.6.3 Various Agencies Supporting SSIs

Prior to 1949, financial assistance to small scale unit was granted mainly by State agencies. Thereafter specialised institutions like

State Financial Corporations (SFCs), National Small Industries Corporation (NSIC), State Small Industries Corporations (SSICs) and State Directorates of Industries were set up to meet the credit requirements of Small Scale Industries. From 1956 commercial banks have been extending various types of credit facilities in an intensive manner. At the apex level, a SSI Board, headed by the Development Commissioner (SSI) oversees the establishment and healthy growth of SSI units.

3.6.4 Why registration?

Registration with State Directorates of Industries helps a unit to obtain all facilities and assistance from Government. Registration of small scale units is done in two stages (a) Provisional registration and (b) Registration.

Provisional registration enables the units to apply for and obtain facilities such as sheds or construction of sheds in industrial estates, water and power connections, financial assistance, machinery on hire-purchase etc. from Central/State Government Organisations. Provisional registration is granted at the District Industries Centre (DIC) level within a period of seven days after receipt of application. After the unit has taken all steps to commence production, it can apply for permanent registration.

3.6.5 Extension services of SIDO

Small Industries Development Organisation (SIDO) acts as a policy formulating, coordinating and monitoring agency for the development of small scale industries at national level. It provides a wide range of extension services through its network of Small Industries Service Institutes (SISI), Testing Centres, Process-cum-Product Development Centres, Central Tool Rooms, Central Institute of Hand Tools and Production Centres. Each of these Institutes is fully equipped with technical officers, workshop and testing facilities to provide technical and other assistance to small scale food units in the area of their location.

- i) Economic Information: Industry prospect sheets, area survey reports, project profiles, feasibility study reports are brought out by SIDO which provide information on the scope for development of various industries.
- ii) Technical Assistance: SIDO provides technical consultancy on the model

and design of technical processes, use of modern machines and equipments, preparation of designs, lay-out of machinery and assistance on all aspects of production.

- iii) Quality Improvements and Testing: With a view to improving the quality of products being manufactured in the small scale sector, Testing Centres and Stations have been set up in the area of concentration of specific groups of industries to provide specialised testing facilities for a particular product or industry-group.

- iv) Industrial Management & Training: SIDO offers consultancy services in the field of techno-managerial, marketing, quality control, production, finance, labour laws, etc. and undertakes special training programmes, in-plant studies, open house discussions and seminars. A panel of consultants consisting of reputed engineers, technologists, scientists etc. on every branch of technology has been drawn up for such jobs or projects where expertise is not available with SIDO. In backward areas, the small scale units can avail of the services of these consultants and the entire expenditure is borne by SIDO. In other areas the units have to bear 75% of the cost while the rest is borne by Small Industries Development Organisation.

3.6.6 Development Programmes

- i) District Industries Centres: The District Industries Centres Programme was launched in 1978 to provide a focal point for the promotion of Small, Tiny, Village and Cottage Industries and to provide services and support to the decentralised industries sector under one roof.

- ii) Incentives in Backward Areas: The Government has provided several incentives to enable entrepreneurs to establish industrial undertakings in backward areas. These include concessional finance, out-right subsidy upto 25% of fixed capital investment, preferential treatment in licences, transport subsidy upto 75% of the transport cost of industrial raw materials and finished goods in the selected areas.

- iii) Entrepreneurial Development Programmes: The implementation of an Entrepreneurial Development Programmes and creation of awareness in people towards setting up of a small scale industry are two important

elements for industrial development and reduction of unemployment. A number of entrepreneurial development programmes are, therefore, being organised by SIDO through Small Industries Service Institutes and their branches with the help of the State Directorate of Industries, State Financial Corporations, Commercial Banks and other development agencies for the benefit of different target groups consisting of both skilled/semi-skilled and educated/uneducated persons. These programmes are organised for engineering and non-engineering entrepreneurs. Entrepreneurial Development Programmes for non-engineers include women, rural artisans, technicians, weaker sections of the society, educated unemployed and the physically handicapped.

iv) Ancillary Development and Sub-contracting Exchanges: Under the ancillary development programme, individual items are identified for ancillarisation and small scale industries are assisted for securing sub-contract jobs with a view to providing them effective marketing support. As a part of this programme sub-contracting exchanges promote ancillarisation; they act as an information-house for matching the requirements of medium/large undertakings looking for sub-contractors with small scale units desirous of securing orders from medium/large undertakings.

v) Modernisation Programmes: The modernisation Programme envisages upgradation of obsolete technology of small scale industry through identification of their input needs in rural, urban and backward areas of the country. The main objectives of the programme are:

- a) Improvement in production technology
- b) Product Development Design
- c) Testing, Design and Quality Control
- d) Machinery and equipment
- e) Selection of proper raw material
- f) Application of improved management technology.

Under the Modernisation Programme seminars, industrial clinics, industrial workshops, modernisation courses and study visits are organised.

vi) Government Stores Purchase Programme: The National Small Industries Corporation verifies the competence of small scale units for

executing Government orders and enlists them for participation in Government Stores Purchase Programme. A number of items are reserved for exclusive purchase, some items for purchase upto 75% and others for purchase upto 50% of the requirements from small scale industrial units by the Government purchasing agencies. A price preference extending upto 15% is given to small scale units over medium/large scale units.

- vii) Assistance to Young Engineers: Under the Assistance to Young Engineers Programme training is provided through specific agencies to unemployed engineers. The programme envisages financial assistance to trained engineers in the form of subsidy on interest payable on loans taken by them from banks/financial institutions for acquisition of fixed assets. The quantum of subsidy is the difference between the interest at the rate of 7% per annum and the normal rate charged by the banks/financial institutions on the loans so advanced. The scheme has been further liberalised to cover non-trained engineers subject to certain conditions.
- viii) Industrial Estates: The facilities being provided by the State Governments to entrepreneurs in the Industrial Estates include built-up factory sheds; power and water facilities, roads, godowns, workshops, common facility services etc.
- ix) Reservation of Items for Production: With a view to giving protection to small scale units, a number of industries have been reserved for exclusive production in the small scale sector. In food sector these are: Ice Cream, Pickles & Chutneys, Vinegar, Rice & Pulse Milling, Bread, Biscuits, Confectionary (except Chocolates), Rapseed, Mustard, Sesame & Groundnut oil except solvent Extracted, Sweetened Cashewnut Products, Poultry Feed, Ground and Processed Spices, Tapioca Sago and Flour etc.
- x) Export Promotion: Small Industries Development Organisation provides export marketing information, export consultancy and organises training courses and seminars for promoting exports from small scale sector.

Trade delegations and study teams are sponsored from the small scale sector to help them develop contacts with foreign buyers. Under this

programme 60% of the expenditure incurred by trade delegations and teams on admissible items is met by the Ministry of Commerce under the Marketing Development Assistance Scheme.

Under the advanced licencing scheme small scale units are able to import raw materials, components, spares etc. required for export production without payment of customs duty and with/without having export orders in hand.

Similarly, under the Imprest Licencing Scheme, small scale units can obtain licence for import, outside the duty exemption scheme. Other facilities provided to small scale industries under the Import and Export Policy through Ministry of Commerce are as follows:

- a) Import Replenishment under the scheme of Registered Exporters;
 - b) Cash Compensatory support;
 - c) 100% export-oriented units;
 - d) Duty drawback;
 - e) For recognition as export houses in small scale sector minimum limit prescribed by select products and non-select products is equivalent to US\$ 600,000 and US\$ 2.3 million respectively;
 - f) Supply of export credit at concessional rates etc.
- x i) Seed/Margin Money Scheme: The objective of the Margin Money Scheme is to assist the State Governments to reduce the incidence of sick units and thereby ensure better utilisation of installed capacities in small scale sector.
- x ii) National Small Industries Corporation: National Small Industries Corporation promotes small scale industries by providing supply of machinery on hire-purchase, enlistment of small scale units for participation in the Government Stores Purchase Programmes, distribution of raw materials, marketing of small industries products and extension of marketing assistance at institutional level and providing prototype development and training facilities through Prototype Development-cum-Training Centres.
- x iii) Self-Employment Scheme: The scheme provides self-employment opportunities to educated unemployed youth who are matriculate, are within the age group of 18-35 years, and do not belong to affluent section

of the society. Eligible youth are provided a composite loan of US\$ 3,000 to set up small industry, without offering any margin or security. The government assistance in the form of capital subsidy to the extent of 25% of the loan contracted is provided to such youth.

3.6.7 Financial Assistance:

A net-work of State Financial Corporations, National Small Industries Corporation, State Small Industries Corporations, Commercial Banks, Cooperative Banks and Regional Rural Banks provides financial assistance to small scale units. Industrial Development Bank provides re-finance to the industrial loans advanced by these institutions to small scale sector.

- i) State Financial Corporations (SFCs): State Financial Corporations grant term loans for the purchase of land, construction of factory premises and purchase of machinery and equipment for the setting up of new industries or for expansion or modernisation of the existing ones. SFCs generally prescribe a margin of 25% and allow an initial holiday of two years for the loan repayment (this period can be increased to five years in backward areas).
- ii) National Small Industries Corporation(NSIC) and State Small Industries Corporations (SSICs): NSIC and SSICs supply machinery on hire-purchase basis to small scale and ancillary industries, the value of which should not exceed US\$ 300,000 and US\$ 350,000 respectively, inclusive of the value of machinery and equipment already installed. The payment for the machinery and equipment is made directly to the suppliers. The hire purchase value is generally recovered in 13 half-yearly instalments and a rebate of two per cent allowed if the instalments are paid before the due date. While NSIC supplies both imported and indigenous machinery, SSICs supply only indigenous machinery.
- iii) State Directorates of Industries: State Directorates of Industries extend assistance ranging between US\$ 800 to US\$ 4,000 for the construction of factory premises, purchase of machinery and equipment and working capital. These loans are repayable in five to seven years.

iv) Commercial Banks: Commercial Banks provide short term and medium term financial assistance. The short term credit facilities are granted for working capital requirements of the units like those for raw materials, goods-in-process, finished products, bills receivables and book debts. The medium term loans are granted for the acquisition of land, construction of factory premises, purchase of machinery and equipment and operative expenses. These loans are generally granted for periods ranging from five to seven years. They also establish letters of credit on behalf of their clients favouring suppliers of raw materials/machinery (both domestic and foreign) which extend the bankers' assurance for payment and thus help their delivery. Certain transactions, particularly those in contracts of sale to government departments, may require guarantees being issued in lieu of security/earnest money deposits for release of advance money, supply of raw materials for processing, full payment of bills on assurance of performance etc. Commercial banks issue such guarantees also.

v) Industrial Development Bank (IDB): The industrial Development Bank, the apex developmental body for small, medium and large industries, extends assistance to SSI units through two major schemes:

a) Bills Re-discounting Scheme, under which the manufacturers of indigenous machinery/capital equipment can offer deferred payment facilities to their buyers (the period of such payment being not less than six months and not more than five/seven years), the related bills, accepted/guaranteed by the buyer and/or his bankers, can be discounted by the manufacturer with his own bank to realise the cost of machinery immediately. The latter, in turn, re-discounts the bills with IDB and obtains the amount paid. Subsequently he takes them back before their due dates and presents them for payment before the buyer/his guarantor.

b) Refinance Scheme, under which IDB refinances eligible term loans granted by banks to the SSI borrowers.

The Industrial Development Bank and some commercial banks have promoted State Technical Consultancy Organisations to extend consultancy assistance to entrepreneurs.

- vi) National Bank for Agricultural and Rural Development (NABARD): The National Bank for Agricultural and Rural Development was set up in 1982 to provide re-finance assistance to State Cooperative Banks, Regional Rural Banks and other approved institutions for all kinds of production and investment credit to small scale industries, artisans, cottage and village industries, handicrafts and other allied activities.
- vii) Specialised Institutions: Technical assistance and guidance in a wide range of subjects is provided through specialised institutions and experts available with different development organisations.

3.6.8 Fiscal Incentives

a) Concessions under income tax laws

- i) Investment Allowance: An investment allowance of 25% of the actual cost of the new plant and machinery installed by a small scale industrial unit is allowed as deduction subject to certain conditions including the requirement of the creation of a reserve of not less than 75% of the allowance. An investment allowance is allowed at the higher rate of 35% to the users of know-how developed within the country.
- ii) Amortisation of certain Preliminary Expenses: Certain preliminary expenses like expenditure incurred on preparation of feasibility report, market survey etc, legal charges for drafting agreement, printing expenses of the memorandum and articles of association, registration fees of the company, expenses on public issue of shares or debentures of the company etc. are allowed for amortisation subject to the condition that the aggregate amount is not to exceed 2.5% of the cost of the project. The amortisation is allowed against the profits in ten equal instalments over a period of ten years.
- iii) Additional Depreciation for New Plant and Machinery: In addition to the normal depreciation allowance, an additional depreciation at the rate of 50% of the normal depreciation allowance is allowed in respect of new machinery or plant installed, subject to certain conditions.

iv) Tax concession in respect of newly set up small scale industrial Undertakings in rural areas: A deduction equal to 20% of the profits derived from a new small scale undertaking set up in rural area is allowed while computing the taxable income subject to certain conditions. This deduction is admissible for a period of 10 years and is available in addition to the normal deductions under the Income Tax Act.

v) Tax Holiday for New Industries: A deduction equal to 20% of the profits derived from a new industrial undertaking is allowed for the purpose of determining the taxable income for the first eight assessment years (in backward areas this period is 10 years). This is a concession available to all the new industrial undertakings irrespective of their location. While this concessions is not available to the large and medium industries in the non-priority sector, an exception has been made in the case of small scale industries.

b) Concessions under Excise Tariffs

The salient features of a new scheme of Excise concessions for small scale units are:

i) Exemption/Preferential Rates

| <u>Value of clearance in a year</u> | <u>Rate of duty</u> |
|--|--|
| - Upto US\$ 125,000 | Fully exempt* |
| - Above US\$ 125,000 and upto US\$ 625,000 | Normal duty reduced by 10 percentage point subject to a minimum duty of 5% ad-valorem. |
| - Above US\$ 625,000 and upto US\$ 1.3 million | Normal duty. |

ii) Eligibility: The above scheme would apply to all units whose clearances in the preceding financial year did not exceed US\$ 1.3 million and which are registered as SSI units with the State Directorate of Industries. However:

*In case of units which produce more than one article falling under different tariff headings, the limit of exemption can go upto US\$250,000.

- a) units whose value of clearances in the preceding financial year did not exceed US\$ 62,500; or
- b) is not likely to exceed US\$ 62,500 during the current year; or
- c) which have been availing of the various exemptions for the small sector,

would be exempted from the conditions regarding registration as SSI units.

- iii) All these units whose value of clearances do not exceed US\$ 85,000 will not be required to obtain a Central Excise Licence.

c) Incentives and concessions provided by state governments, local governments and their agencies:

The primary responsibility for executive action in regard to the development of small industries and the implementation of the programme of assistance is that of the state governments and their agencies. To attract the promotion of small scale industries in their States, they offer numerous incentives and concessions to the entrepreneurs, besides those of the Central/Federal Government and organisations. These include cash subsidy, sales tax incentive, exemption from payment of electricity duty, concessional power tariff, water subsidy, loans for purchase of Diesel generating sets, Octroi exemption, exemption from Stamp duty, subsidy on preparation of feasibility study, subsidies for prevention and control of water pollution, for the purchase of testing equipment, marketing assistance, allotment of land/shed in industrial areas, loans for working capital, subsidy for housing of workers etc.

3.7 Legal Requirements

In their paper 'The case for Labour Intensive Industries in Malaysia', Chee Peng Lim et al pointed out that the efficiency of small scale industries was not up to the mark due to certain operational inadequacies vis-a-vis legal requirements.

A number of countries have several acts relevant to the operations of a factory. Their provisions ensure smooth operation of the plants and provide a better environment and working conditions. Some of them are:

- i) Factories Act: The Factories Act lays down the minimum health measures and welfare measures which are to be adopted. They safeguard the safety and the general welfare of the workers. Certain restrictions on the working hours as well as age of employees and their fitness to work are also imposed. The act imposes criminal liability on the occupier or the manager of the factory for certain acts of commission or omission.
- ii) Payment of Wages Act: This Act seeks to regulate the timely payment of wages to persons employed in the industrial establishments.
- iii) Payment of Bonus and Gratuity Acts: The Acts define the minimum bonus and gratuity payable to the eligible employees.
- iv) Employees Provident Fund Act: This Act details the extent of contribution to be made, eligibility for membership, duties and responsibilities of the employer and penalties levied.
- v) Employees State Insurance Act: This act gives a list of obligations on the part of the employer and rates at which premia is payable for the insurance coverage of employees.

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4. CONCLUSION

A close examination of the policy recommendations made by Ali and Salleh (UNIDO Report) with regard to the "Nursery Factory Scheme" will reveal that most of the problems in the Pengkalan Chepa project arose due to certain weaknesses. Major constraints of marketing, raw material procurement, financial and technical services, managerial training, plant efficiency, linkages etc. could be avoided.

At the end I hope the above compendium of approaches, strategies and mechanisms adapted and followed in a developing country can definitely help in developing and sustaining the small scale food industry sector. Owing to the basic weakness and handicaps of small-scale industry and the shortage of institutional agencies to provide the services and facilities needed, the Government in Malaysia may wish to assume certain special responsibilities for its development. The most important contribution the Government can make is to adopt those policies and programmes which will facilitate the healthy growth of enterprises in this sector.

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