

Step-by Step approach to start an MSME

1. Identifying the opportunity

It all begins with an Idea

The overriding reason for anyone to think of establishing a MSME unit can be summarised in one word - opportunity. An opportunity to provide a product or service, which can generate sufficient surplus. This is all the more true if one is a believer in the maxim, "Small is Beautiful".

However, ideas need to be filtered through a multi-layer sieve. This model is shown in the following flow:

- Does the idea fire up your motivation?
- Is it a viable business proposition in your area?
- Does it match the needs of your clientele?
- Check it out with basic market research
- Test it out at market place
- Consult with the experts
- Look out for competition in the field
- Is it a sunrise industry?
- Your business opportunity
- Project conceptualisation

Once the ideas are screened and a viable business opportunity emerges the project has to be conceptualised in all its dimensions. The 4 Ps of Project Conception is:

- **PRODUCT** (Shape, Size and Nature)
- **PROCESS** (Technology to produce the product)
- **PLACE** (Location of Plant)
- **PARTNER** (Technological or Financial Collaborator)

2. Making a Product Choice

In a project conceptualisation stage while making a product choice following factors are related to product need to be considered:

- Product Line - Depth, Width
- Packaging
- Branding
- Warranties
- After Sales Service

Some other factors that one should consider while finalising the product choice are:

- Ease of availability of raw-material
- Process Technology

- Accessibility to the market
- Incentive and support from Government

Market information is also important for product selection. Products, which are likely to have a number of players in the market, are best avoided. Some such products in the recent past have been plastic footwear, audio cassettes, disposable gloves and bulk drugs.

In case the entrepreneur is looking for a product, which has export potential, the following additional questions need to be asked:

- What should be the contents of export-product portfolio?
- What are the special requirements for packaging if one has to export the products?
- What product adaptations are needed to be made for exporting a product to a specific country?
- Are any WTO conditionalities involved e.g. "child labour free", ISO 9000 certified, GMP followed etc.

The development of export-product portfolio can be done by considering 4 parameters viz.

- External demand conditions
- Internal supply capability
- Complexity of marketing tasks
- Amount of investment required to penetrate the market

Analysis can be conducted using this four dimensional model. The obvious choice is a product which scores a high rating on first two parameters and low rating on last two parameters.

EXIM (Export Import Bank of India) Bank has also developed an excellent model to conduct the export-product portfolio analysis based on three parameters viz.

- Supply Capability In Product Group
- Domestic Environment
- Export Market Attractiveness

This analysis gives rise to product groups with high potential or low potential.

With regard to special packaging requirements one has to be careful about laws of the country one is exporting to. For instance, while exporting to Australia, wooden-packaging cannot be done.

Product adaptations for country's specific needs look into things like whether voltage supply is 220V or 110V for electric appliances and for automobiles whether left-hand drive or right-hand drive is appropriate.

It has now become important to understand the implications of the various agreements which form part of WTO.

Once the product is finalised, choices of process technology emerge.

3. Process Selection

Choices of process technology emerge once the product is finalised. For some complex products, process know how has to be imported. In such cases agreements for technology transfer should be made with due care to safeguard interest. A lot of appropriate technology is being developed at CSIR and Defense Research Labs and some of this technology can now be bought. Indigenously developed process know-how has intrinsic benefits such as appropriateness and relative inexpensiveness.

While checking out on a process technology, the following things need to be considered with utmost care:

- Whether process requires very high level of skilled workers or complex machines?
- Whether process requires large quantities of water and/or power?
- Whether any process or product patent needs to be honoured while utilising the selected process technology.
- Any special pollution or environmental regulations.
- Finally, the appropriateness to the indian environment and conditions. Machinery and equipment

One of the major deficiencies in the micro, small and medium enterprises scenario is the prevalence of outdated production and management methods hindering the efficient operation of micro, small and medium-scale units. It was also found that the most important reason for the reluctance of the small industrialists to install modern machinery and equipment was the lack of investible funds. The main objective of National micro, small and medium enterprises (NMSME) is to provide machinery and equipment to small industrial units offering them long repayment period with moderate rate of interest.

4. Arranging Finance

No MSME unit can take off without monetary support. This need for finance can be classified into following types:

- Long and medium term loans
- Short term or working capital requirements
- Risk Capital
- Seed Capital/Marginal Money
- Bridge loans

Financial assistance in India for MSME units is available from a variety of institutions. The important ones are:

- (i) Commercial/Regional Rural/Co-operative Banks.
- (ii) SIDBI: Small Industries Development Bank of India (refinance and direct lending)

(iii) SFCs/SIDCs: State Financial Corporations (e.g. Delhi Financial Corporation)/State Industrial Development Corporations.

Long and medium term loans are provided by SFCs, SIDBI and SIDCs. Banks also finance term loans. This type of financing is needed to fund purchase of land, construction of factory building/shed and for purchase of machinery and equipment. The short-term loans are required for working capital requirements, which fund the purchase of raw materials and consumables, payment of wages and other immediate manufacturing and administrative expenses. Such loans are generally available from commercial banks. The commercial banks also sanction composite loan comprising of working capital and term loan up to a loan limit of Rs.1 crore.

For loans from financial institutions and commercial banks a formal application needs to be made. The details of documentation that need to be provided with the loan application are indicated below:

- Documentation for Loan Application
- Balance Sheet and Profit Loss Statement for last three consecutive years of firms owned by promoters
- Income Tax Assessment Certificates of Partners/Directors
- Proof of Possession of Land/Building
- Architect's estimate for construction cost
- Partnership deed/Memorandum and Articles of Associations of Company
- Project Report
- Budgetary Quotations of Plant and Machinery

A sanction or rejection letter is issued by bank after its assessment of the application. After receiving a sanction letter, applicants need to indicate in writing their acceptance of terms and conditions laid down by FI/Banks.

Subsequently, loan is disbursed according to the phased implementation of the project. In today's environment there are other choices apart from commercial banks and Government owned financial institutions. These options include venture capital funds and non-government finance companies.

5. Filing of Entrepreneurs Memorandum

Section 8 of the **Micro, Small and Medium Enterprises Development (MSMED) Act, 2006** provides for filing of memorandum by a Micro, Small or Medium Enterprise. Sub-section (2) of section 8 stipulates that the form of the Memorandum, the procedure of its filing and other matters incidental thereto shall be such as *notified* by the Central Government.

- The memorandum may be filed by all three categories of enterprises with the District Industries Centre in the jurisdiction of which the enterprise is (or, is proposed to be) located,
- The procedure for filing it has been outlined in Schedule. II of the **Notification** for the format of EM,

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File Format for Entrepreneurs Memorandum

Features of the Scheme

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Procedure for Filing Memoranda

Features of the present procedures are as follows:

- Form of the Entrepreneurs Memorandum can be downloaded from the Internet, the address of which can be obtained from Directorate dealing with Micro, Small & Medium Enterprises of the State Governments/ UTs. or the hard copies of the same can be obtained from the District Industries Centres. This form can also be downloaded from the SIDO website i.e. www.laghu-udyog.com or www.dcmsme.gov.in
- Any person who intends to establish a micro or small enterprise, at his discretion; or a medium enterprise engaged in providing or rendering of services may, at his discretion or a medium enterprise engaged in the manufacture or production of goods shall file the Memorandum of Micro, Small or as the case may be, of Medium Enterprise with District Industries Centre of its area.
- The District Industries Centre shall fill all the codes in the form of the Memorandum and issue an acknowledgement after allotting an EM number, date of issue and category of the unit within five days of the receipt of the form of Memorandum by post or same day, if the form of Memorandum is submitted in person as well as online.
- Before issuing the acknowledgement, the District Industries Centers shall make sure that the form is complete in all respect and particularly the form is signed and is accompanied with an undertaking, which is a part of the form of Entrepreneurs Memorandum.
- The District Industries Centre shall maintain record of all the Entrepreneurs Memorandum so filed in respect of micro and small enterprises and medium enterprises engaged in providing and rendering services. District Industries Centers shall forward a copy of the Entrepreneurs Memorandum so filed with EM number allotted to the Small Industries Service Institutes of their State/Jurisdiction.
- The District Industries Centre shall maintain record of all the Entrepreneurs Memorandum so filed in respect of medium enterprises engaged in

production/manufacturing of products and forward one copy each of the Entrepreneurs Memorandum with EM number allotted to Small Industries Service Institutes of their State/Jurisdiction and to Joint Development Commissioner (MSME Pol.) in the Office of the Development Commissioner (Small Scale Industries).

- The form of Memorandum is in two parts. Any person who intends to establish a micro, small or medium enterprise engaged in providing or rendering of services may file or those who want to establish medium enterprise engaged in the production or manufacture of products shall file Part I of the Entrepreneurs Memorandum to District Industries Centre.
- Once the above enterprises start production or start providing or rendering services, they should file Part II of the Entrepreneurs Memorandum to District Industries Centre.
- In case of non-filing of Part II of the Entrepreneurs Memorandum within two years of the filing of Part I, the Memorandum (Part I) filed by the entrepreneur will become invalid.
- In case of change in the investment in plant and machinery or in equipment, the enterprises who have already filed Entrepreneurs Memorandum should inform the District Industries Centre of the same in writing within one month of the change in investment.
- In case of change of products and that of services or addition in products or services, the enterprises who have already filed Entrepreneurs Memorandum should inform the District Industries Centre of the same in writing within one month of the change.
- The District Industries Centre shall, in addition of keeping a record, in writing, shall also maintain records electronically on computer.

The following form basis of evaluation:

- The unit has obtained all necessary clearances whether statutory or administrative. e.g. drug license under drug control order, NOC from Pollution Control Board, if required etc.
- Unit does not violate any locational restrictions in force, at the time of evaluation.
- Value of plant and machinery is within prescribed limits.
- Unit is not owned, controlled or subsidiary of any other industrial undertaking as per notification.

6. NSIC procedures for hire purchase of machinery

- The hire purchase application is to be made on the prescribed form.
- The Director of Industries of the State under whose jurisdiction the applicant falls,

forwards the application to the head office of the NSIC at Delhi with his recommendation and comments.

- All applications for indigenous or imported machines are considered by acceptance committees comprising of the representatives of the Chief Controller of Imports, Development Commissioner, micro, small and medium enterprises and other concerned departments.
- Decision of these committees is conveyed to the parties concerned with copies to the regional offices of the NSIC and the concerned Directorate of Industries.
- Once all these formalities are completed by the hirer, instructions are sent to the suppliers to dispatch the consignment (duly insured for transit risk) to the hirer and to send the R/R or C/R as the case may be, to the regional office
- The NSIC after ensuring that all dues have been paid by the hirer, releases the R/R or C/R to him for taking delivery of the machines.
- In case of imported machines, the procedure is slightly different in as much as the shipping documents are sent to the clearing agents for clearing the consignment from the Customs and dispatching it to the hirer.

Value of machines that can be supplied

Rs. 7.5 Lacs, F.O.R. or landed cost as the case may be.

Earnest Money

5% or 10% of the value of machinery depending on whether the equipment is imported or indigenous. In the case of furnaces and a few other items of equipment, the rate of earnest money is different. Interest 9 per cent per annum with a rebate of 2 per cent on prompt payment. This interest is calculated on the value of machines outstanding after deducting payment of earnest money.

Administrative Charge

2 per cent on the sales value of machines and its recovery by the NSIC is spread over the total installment period.

Period of Repayment

The value of the machines, after deducting the earnest money received, called the Balance Value, is payable along with interest and administrative charge in 7 years.

- The first installment is payable after one year and six months from the delivery of machines
- The second and subsequent installment is payable half-yearly thereafter.

Gestation Period

In case of certain type of machines which become operative immediately on installation in the service sector industries and job order establishment, a gestation period of only 6 months shall be allowed both to the new and existing units.

A rebate of 2% per annum is allowed on the interest rates, in case an installment is paid on or before the due date.

In case the payment of installment is not made within one month of the specified due date, interest @ 2% per annum over and above the normal rate is charged on the defaulted amount from the date of default to the date of actual payment. Remission in interests is allowed in case one or more than one installment is paid in advance of the due date(s).

Now the Place and Right Partner has to be selected and Project Report has to be prepared.

After deciding the issues of product and process, the next important question is where to set the unit up?

For many tiny units and service-based units, the home is perhaps the best starting point.

Setting up an establishment is much more than putting a signboard up and waiting for customers to walk in. It requires negotiating a favourable plot or shed purchase, organising for proper construction of building, design of interiors and finding good deals for equipment and machinery.

7. Construction of Building

Once an industrial plot for the unit is secured, then the next job is that of finding a suitable architect. Design of factory building has to be in consonance with the type of industry and have an appropriate plant layout.

An architect's estimate of building construction is essential for loan applications. Further, architect's certificate for money spent on building is needed for disbursement of loan.

8. Getting the Utility Connections

Among the utilities of prime importance are power and water. In many cases getting power connection causes delay in setting up of plant. Therefore it is imperative to commence work on these aspects with diligent follow up. Power connections are generally of either LT (Low Tension) or HT (High-tension) type. If connected load is upto 75 HP, LT connection is provided. For connected loads of 130 HP or higher only HT connection is provided.

A formal application needs to be made in a specified form to the state electricity board. An electrical inspector is deputed for evaluation of application to factory site,

after which the load is sanctioned. In areas of power shortage, it is advisable to augment the power supply with a captive generating set.

Water connection is also obtained likewise by applying in advance in formal forms. The water supply can be augmented by installation of tubewell.

9. Getting 3M's Right

Men

Projections for manpower and staffing are made in the project report. However it is necessary to time the induction of manpower in a planned manner. The engineers and operatives must be available before the installation of the machinery.

Machinery

Choosing and ordering of right machinery is also of paramount importance. In many cases technology or process provides us with specifications which is not provided, then an extensive techno-economic survey of machinery and equipment available must be carried out. International trade fairs and engineering fairs are good places to look at available options. The entrepreneur must also consult experts, dealers / suppliers as well as users, prior to making a selection of equipment and machinery. The advice of DIC, MSMEI and NSIC can also be sought.

Materials

Materials procurement and planning are critical to success, of a start-up with a MSME unit. Inventory management can lead to manageable cash flow situations; otherwise if too much is ordered too soon considerable amount of working capital gets locked up. On the other hand, non-availability may result in production hold-ups, and idle machine and manpower. For essential imported raw material whose lead-time is large proper planning is all the more essential.

Every SSI unit has to comply with various regulations in force. These include regulatory, taxation, environmental and certain product specific clearances. This section looks into the methodology of obtaining these approvals and clearances.

10.. Exemption from Compulsory Licence

Licensing in the Industries sector is governed by the licensing exemption notification issued by Govt. of India in July 25 1991 under the Industries (Development and Regulation) Act, 1951. In SSI, there are virtually no licensing restrictions. No industrial license is required except in case of 6 product groups included in compulsory licensing (these products groups mainly cover products that can only be made in large sector.)

But if a small-scale unit employs less than 50/100 workers with/without power then it would not require a license from the Govt. of India even for the 6 product groups covered in licensing under Schedule II of the notification.

Subject to this, an entrepreneur can set up a SSI unit anywhere in the country without any restriction. The units are, of course, subject to the locational/land use and zoning restrictions in force under the local laws.