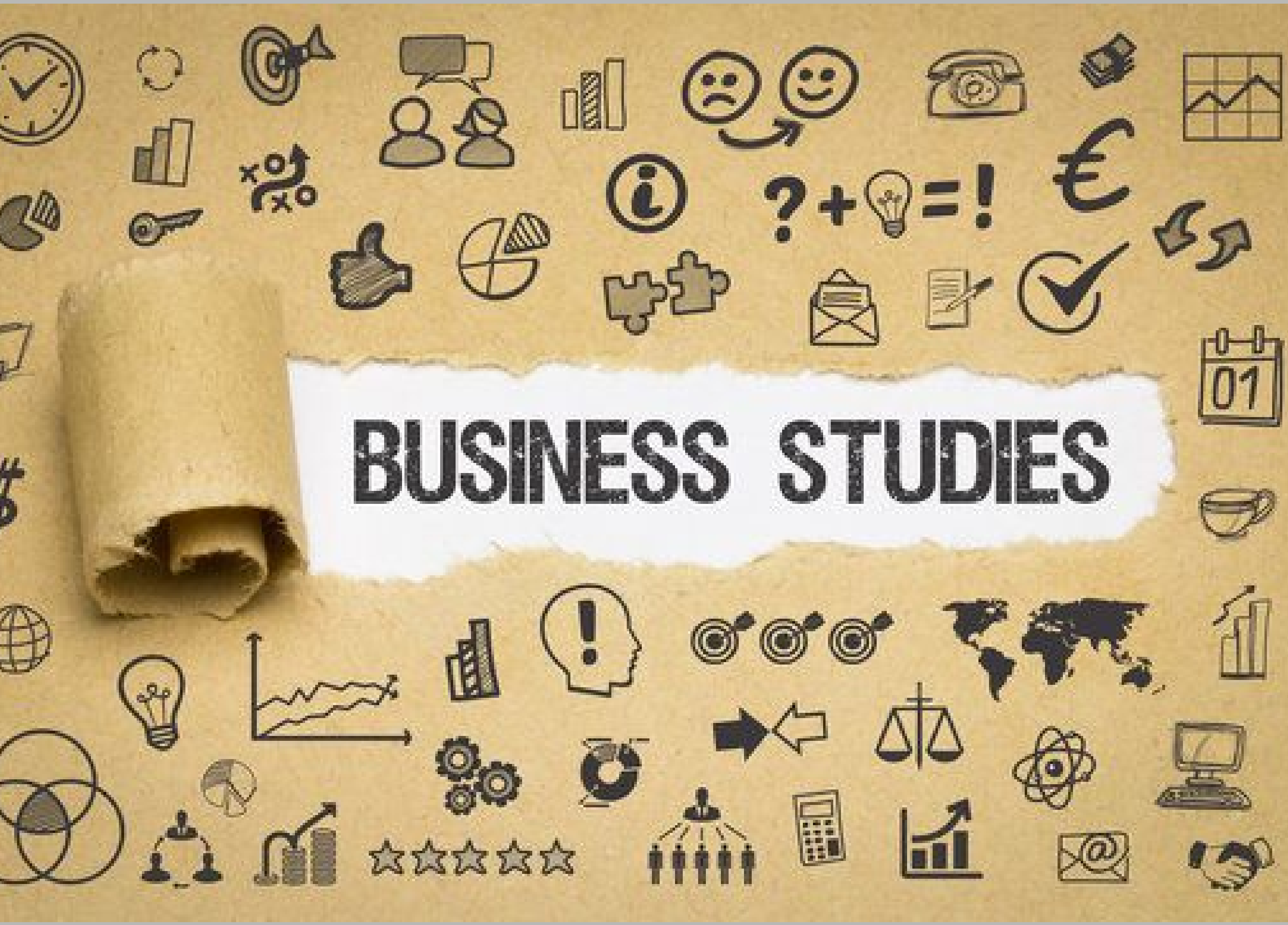
TEXT BOOK FOR

SR.SECONDARY COURSES



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CONTENT - A

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NATURE AND SCOPE OF BUSINESS

In your day-to-day life you may be engaged in several activities. However, when some one asks you as to what you want to become in your life or what you want to do in future, your answer may be – "I want to join a suitable job or I want to become a doctor, an engineer, a dancer or a musician", or you may say, "I want to do my own business". But why do you want to do any of such activities? Obviously, it is mainly to earn your livelihood. Broadly speaking, every human activity in which one is engaged for the purpose of earning one's livelihood is known as economic activity. In this lesson we shall learn about all such activities, their categorisation and some other related aspects.

OBJECTIVES

After studying this lesson, you will be able to:

- define human activities;
- classify human activities as economic and non-economic activities;
- explain the role of profit in business;
- explain the meaning and characteristics of different categories of economic activities;
- explain the concept of business and distinguish it from profession and employment;
- describe the objectives and importance of business in modern society; and
- identify different types of business activities.

1.1 HUMAN ACTIVITIES

Every human being is engaged in one activity or the other. It may be cultivating land, preparing food, playing football, reading storybooks, studying in a school, teaching in a college, working in an office, jogging in the park and so on. If you try to ascertain as to why individuals engage themselves in one activity or the other, you will find that by doing such activities they are trying to satisfy some of their needs or wants. All these activities which human beings undertake to satisfy their needs or wants are called human activities.

However, even if all human activities satisfy the needs and wants, they differ among each other in terms of the purpose for which they are undertaken and the end result. For example, let us take the activity of preparing food – one prepared by a mother at home for her family and the other by a cook in a hotel. Here you will notice that the purpose and end result of the activity of preparing food (a) by a mother and (b) by a cook varies. In the first case, the purpose is to feed the family members without any expectation of monetary return while in the second case, cooking food is a part of his job so as to earn money in terms of salary or wage. The end result in the first case is 'self-satisfaction' and looking after the family, while in the second case it is 'earning money' for livelihood.

The human activities that are undertaken with an objective to earn money or livelihood are called **economic activities**. Whereas the other types of activities that are undertaken to derive self-satisfaction, are called **non-economic activities**. A farmer growing crops, a worker working in a factory for wage/salary, a businessman engaged in buying and selling of goods are examples of economic activities. While activities like meditation, engaging in sports for physical fitness, listening to music, providing relief to flood victims etc., are examples of non-economic activities.

INTEXT QUESTIONS 1.1

1. Define 'economic activities'.
2. Below are given certain non-economic activities. Convert them into economic activities.

   Example: A nurse attending her ailing son. (Non-economic activity)

   A nurse attending patients in her hospital. (Economic activity)

   (a) A person working in his own garden.

   (b) A lady preparing food for her husband.

   (c) A man white-washing his own house.

   (d) A teacher teaching his son at home.

   (e) A chartered accountant preparing his own accounts.

1.2 CLASSIFICATION OF ECONOMIC ACTIVITIES

Economic activity can be a one-shot affair or a continuous one. For example, you know how to stitch clothes and one day you stitch a shirt for your friend and he pays some money to you. Of course, this is an economic activity as you have some monetary gain but it is a one-shot affair. But, if you start stitching shirts on a continuous basis and charge money for that, you are said to be engaged in some continuous or regular economic activity. It may be noted that by getting themselves engaged regularly in a particular economic activity people try to earn their livelihood. So, the activities in which individuals engage themselves on a regular basis and earn their livelihood are known as their **'occupations'**.

In fact everyone is engaged in one occupation or the other, and these can be broadly categorised as –

(a) Profession;

(b) Employment; and

(c) Business.

Let us know a few more details about these occupations.

1.2.1 Profession

You are aware of doctors. What are they and what do they do? They are basically individuals who have a special knowledge and training to examine the patients, find out the ailment, if any, and then treat them to be cured from such ailment. And, for doing all these they charge a fee from patients. Similarly, we have Chartered Accountants who specialise in matters related to accounts, taxes etc. and help people and organisations for such jobs for a fee. If we look further, we find Engineers, Architects, Film-stars, Dancers, Artists and many others engaged in their own field having specialised knowledge and training. They are all known as professionals and the activities they are engaged in are called profession.

In order to gain clarity on the concept of a profession, let us look at its basic features which can be summarised as follows:

(a) Profession is an occupation for which the individual has to acquire a special knowledge and skill.

(b) The money they get for providing such a service is usually known as 'fee'.

(c) Most of the professionals are regulated by a professional body, which frames the code of conduct to be followed by the member professionals. For example, Chartered Accountants in India are regulated by a professional body known as Institutes of Chartered Accountants of India, Cricketers by International Cricket Council (ICC), and so on.

(d) Professionals acquire the specialised knowledge mostly from colleges, universities or specialised institutes. In some cases, individuals also acquire such knowledge and skill through training or coaching by an expert in the same field, say for example, dancers and musicians, etc.

(e) Professionals usually work on their own and get a fee for their services and termed as those in practice. However, some of them may work in organisations as employees or consultants.

(f) The primary objective of every profession is to provide service though they may charge a fee. They should not exploit the people using their knowledge of expertise.

> *All those economic activities which involves the rendering of personal service of specialised and expert nature based on professional training and skill and require the observance of certain rules and regulations (code of conduct) are termed as Professions.*

1.2.2 Employment

You have seen people going regularly to offices, factories, firms etc. for work. These are individuals who are engaged by organisations or individuals to work for them in return for a wage or salary. They are said to be in employment. Thus, we find a postman is in employment in the department of posts to deliver letters. Here the department is called the employer and the postman is the employee. The postman works on the basis of certain terms and conditions and gets a monthly salary in return. The main features of employment are:

(a) It is an occupation where a person (called employee) is to work for another (called employer).

(b) There are certain terms and conditions of work like hours of work (how many hours a day), duration of work (how many days or hours in a week or month etc.), leave facility, salary/wages, place of work etc.

(c) The employees get salary (normally paid on a monthly basis) or wage (normally paid on daily/weekly basis) in return of their work. This amount is normally predetermined, mutually agreed upon and may increase over time.

(d) Legally the employer-employee relationship is based on a contract and any deviation from any side permits the other party to take legal recourse.

(e) There are jobs for which no technical education or specialised skill is required for employment. But, for skilled jobs, specialised jobs and technical jobs, a certain level of basic/technical education is required.

(f) The main purpose behind employment is to secure assured income through wages and salaries.

The economic activity, rendered by one person to another, under a contract of service, for some remuneration, is called employment.

1.2.3 Business

You must have heard about Tata Companies. They manufacture so many things from salt to trucks and buses and sell these to individuals like you and me. In the process, they earn a profit. Look at a shopkeeper nearby. What does he do? He buys products in bulk and sells us in small quantities. He also earns some profit in the process. Similarly, the cable TV operator provides us a connection at a price so that we watch various channels on our television set. In this process the cable TV operator earns a profit. All of them are said to be engaged in business and are called businessmen. They all perform their activities regularly to earn profit. Thus, the term 'business' refers to human activities which involve production or exchange of goods and services regularly with the object of earning profit.

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Business may be defined as an activity involving regular production or purchase of goods and services for sale, transfer and exchange with the object of earning profit.

We find people like mill owners, transporters, bankers, traders, tailors, taxi operators etc. doing business. All of them are engaged in an activity of manufacturing or trading (buying and selling) or providing some service. They have invested their money, bear the risks involved and work for earning some profit. Thus, the main characteristics of business are:

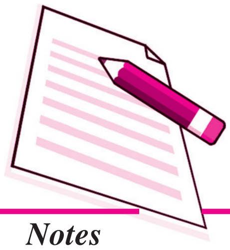
(a) It is an occupation where a person is engaged in manufacturing or buying and selling of goods and services. The goods may be consumer goods or capital goods. Similarly the services may be in the form of transportation, banking, insurance etc.

(b) The activities must be carried on regularly. A single transaction is usually not treated as a business. For example, if a person sells his old car at a profit, it is not treated as a business activity. However, if he is engaged in the activity of buying old cars and selling them on a regular basis, he shall be treated as engaged in business activity.

(c) The sole objective of business is to earn profit. It is essential for the survival of business. Of course, it is through provision of some goods or some services.

(d) Every business requires some investment in cash or kind or both. It is usually provided by the owner or is borrowed by him at his own risk.

(e) The earnings are always uncertain, because the future is unpredictable and a businessman has no control over certain factors that affect his earnings. Thus, every business involves an element of risk and the same is borne by the businessman, the owner.



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INTEXT QUESTIONS 1.2

1. Define the term 'profession' in your own words.

2. Following is a list of activities. Classify these activities as Business, Profession or Employment by putting their number in the circles provided at the end of the question.

   (a) Policeman on duty at your local police station.

   (b) Teacher working in an educational institution.

   (c) A driver driving a bus of a State Road Transport Corporation.

   (d) A taxi-driver who runs his own taxi.

   (e) A fisherman selling fish in a village.

   (f) Gopal stitching cloth of the customers regularly at home.

   (g) A daily-wager working in a factory.

   (h) A gardener maintaining the lawns in a college.

   (i) A lawyer practising in a court.

   (j) An engineer running his consultancy firm.

Business **Profession** **Employment**

1.2.4 Comparison of Business, Profession and Employment

Having learnt about the essential characteristics of business, let us distinguish it from profession and employment.

Basis	Business	Profession	Employment
(a) Establishment	Decision to start the business and compliance of legal formalities like registration, wherever required.	Membership of a professional body is essential.	Enter into service contract with the employer.
(b) Qualification	Specific qualification is not required.	Professional knowledge and training in the same field is essential.	As per the needs of the employer and the job involved.

(c) Capital	Capital investment is a must. Its amount depends on the nature and scale of business operation.	Some amount of capital investment is required for establishment.	No capital investment is required.
(d) Nature of work	Production or purchase and sale of goods or services.	Expert service.	Performance of job.
(e) Return or reward	Profit.	Professional fee.	Wage or Salary.
(f) Risk	There is risk of loss.	Risk of not getting sufficient fee.	No risk, so long as business /office continues its operations.
(g) Motive	Profit motive.	Service motive, though fee is charged.	Motive is to earn a livelihood.

1.3 IMPORTANCE OF BUSINESS

Business is an integral part of modern society. It is an organised and systematic activity for earning profit. It is concerned with activities of people working towards a common economic goal. Modern society cannot exist without business. The importance of business can be described as follows:

(a) Business improves the standard of living of the people by providing better quality and large variety of goods and services at the right time and at the right place.

(b) It provides opportunities to work and earn a livelihood. Thus, it generates employment in the country, which in turn reduces poverty.

(c) It utilises the scarce resources of the nation and facilitates mass production of goods and services.

(d) It improves national image by producing and exporting quality goods and services to foreign countries. By participating in international trade fairs and exhibitions it also demonstrates the progress and achievements of its own country to the outside world.

(e) It enables the people of a country to use quality goods of international standard. This is possible by way of importing goods from foreign countries or by producing quality goods in the country by applying modern methods of production.

(f) It gives better return to the investors on their capital investment and also provides opportunities to grow and expand the business.

(g) It promotes social interest by providing tourist services, sponsoring cultural programmes, trade shows etc. in the country, which enable people of different

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parts of the country to exchange their culture, traditions and practices. Thus, it promotes national integration.

(h) It also facilitates exchange of culture among the people of different nations and thus, maintains international harmony and peace.

(i) It helps in the development of science and technology. It spends large amount of money on research and development in search of new products and services. Hence a number of innovative products and services are developed through industrial research.

1.4 OBJECTIVES OF BUSINESS

Business objectives are something, which a business organisation wants to achieve or accomplish over a specified period of time. It is generally believed that a business has a single objective, that is, to make profit and safeguard the interests of its owners. However, no business can ignore the interests of its employees, customers as well as the interest of society as a whole. Business objectives also need to be aimed at contributing to national goals and aspirations as well as towards international well-being. Thus, the objectives of business may be classified as –

(a) Economic objectives

(b) Social objectives

(c) Human objectives

(d) National objectives

(e) Global objectives

Now let us discuss these objectives in detail.

(a) **Economic objectives** of a business refer to the objective of earning profit and those which have a direct impact on the profit-earning objective of business. Some of the main economic objectives of business are:

(i) earning of adequate profits;

(ii) exploring new markets and creation of more customers;

(iii) growth and expansion of business operation;

(iv) making innovations and improvements in goods and services; and

(v) making use of available resources in the best possible manner.

(b) **Social objectives** of business are those, which are desired to be achieved for the benefit of the society. Some of the major social objectives are:

(i) production and supply of quality goods and services to the society;

(ii) making goods available at reasonable prices;

(iii) avoidance of unfair practices like hoarding, black-marketing, over-charging, etc.;

(iv) contributing towards the general welfare and upliftment of the society;

(v) ensuring fair return to the investors;

(vi) taking steps in the direction of consumer education; and

(vii) conserving natural resources and wild life and protecting the environment.

(c) Human objectives of business primarily refer to the objectives aimed at safeguarding the interest of its employees and their welfare. Some of the major human objectives are:

(i) providing fair remuneration and incentives to the employees;

(ii) arrangement of better working conditions and proper work environment for the employees;

(iii) providing job satisfaction by making the jobs interesting and challenging, putting the right persons in right job;

(iv) providing the employees with more and more promotional opportunities;

(v) organising training and development programmes for the growth of the employees; and

(vi) providing employment to the backward classes of the society and people who are physically and mentally challenged.

(d) National objectives of business are the objectives of fulfilling the national goals and aspirations like:

(i) creation of employment opportunities;

(ii) promotion of social justice;

(iii) produce and supply goods in accordance with the national interest and priorities;

(iv) payment of taxes and other dues honestly and regularly;

(v) helping the state in maintaining law and order by promoting good industrial relations; and

(vi) implementing government's economic and financial policies framed from time to time.

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(e) **Global objectives** of business are the objectives of facing the challenges of global market. Some of the global objectives are:

(i) making available globally competitive goods and services; and

(ii) reducing disparities among rich and poor nations by expanding its operations.

1.4.1 Role of Profit in Business

Profit plays an important role in business. Following points indicate the role of profit in business :

1. **Survival :** Profit helps an organization to replace old assets and increases the capacity of an organization to survive.
2. **Future Growth and Expansion :** Extra profit earned can be utilized for expansion purpose. Entry in new areas helps an enterprise to grow.
3. **Incentive :** Profit is an incentive for businessmen who put hard work. Profit motivates the businessmen to put maximum efforts.
4. **Prestige :** Profit making organizations can afford to give higher wages/salaries and other facilities to their employees. This can retain employees and attract highly competent persons to join the enterprise. So profit making concern enjoys goodwill in the society.
5. **Achievement of Goals :** Only a profit making concern can achieve the goals of an enterprise because achievement of economic objectives require expenditure.
6. **Measure of Efficiency :** The success of an organization can be evaluated by looking at its profit. So profit is an index of success in business. It measures the efficiency of business.
7. **Means of Livelihood to Businessmen :** Profit is a regular income to the family of business persons.

1.4.2 Business Risks

Business is full of uncertainties. Uncertainties can be of different forms like loss due to change in fashion; fall in market price; goods produced may be destroyed by fire, storm, cyclone, theft etc. Thus, while running a business enterprise, there is an element of risk. Business risk means chance of loss due to uncertain events in future.

Nature of Business Risk

1. **Uncertainty :** Business risks is due to uncertainty of the future course of action. Natural clamaties such as flood, earthquake etc. result is loss. Loss may also arise due to human causes like strike, lockouts, accidents, theft, bad-debts etc. There are other uncertainties such as competition, technological changes, price fall etc.

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2. **Profit is the Reward for Risk :** A business concern which is willing to take risk earns handsome profits. Heavy risk results in higher profits.

3. **Difficult to Measure :** A businessman may anticipate some risks. He cannot predict all the risks which will occur in future. Therefore, risk cannot be measured accurately.

4. **Essential Element of Business :** Business activities cannot be conducted without some element of risk. Risk bearing is an essential element of business.

5. **Variability :** According to the nature and size of business, the degree of risk varies. If the amount invested is high, there will be high degree of risk. The degree of risk varies with time and competition.

Causes of Business Risks

1. **Natural Causes :** Fire, flood, storm, cyclone, earthquake, famine, lightning, snowfall, tide etc. result in loss of life, property and income. Therefore, natural causes are beyond the control of business.

2. **Economic Causes :** It refers to change in market conditions. Economic causes can be in the form of fluctuation in demand, fluctuation in price, availability of cheap substitutes, competing business firms etc.

3. **Political Causes :** Fall of government may change license policy and tax policy. This may result in loss to the business. Import and export restrictions, high taxes, rise in interest rate on borrowings etc. may cause loss to the business. Political causes refer to changes in government policies and laws.

4. **Human Causes :** Inefficient management and carelessness of employees may result in loss. Workers may damage machines. They may involve in strike, lockout etc. which may also result in loss. If the management fail in estimating demand for products, loss may arise. Uncertainties caused by human actions e.g. forgery, misappropriation of cash, theft of goods, riots, wars, etc. can also result in loss.

5. **Physical and Technical Causes :** Change in technology may make the machines obsolete before their expected life. Mechanical failures arise due to leakage of gas, bursting of a boiler etc. Value of assets may be reduced due to loss in weight, vaporisation etc. Another kind of physical cause is the loss of goods in transit.

INTEXT QUESTIONS 1.3

1. Mohan has recently completed his MBBS course. He finds difficulty in choosing his occupation. Guide him by filling up the following table:

If he chooses	What should he do?	What will he get as return?
(a) Business		
(b) Profession		
(c) Employment		

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2. Correct the following sentences, if necessary:
   (a) Business minimizes opportunities to work and, thus, generates employment in the country.
   (b) By producing and exporting quality goods and services, the national image of a country goes down.
   (c) Business objectives should concentrate on profit earning only.
   (d) Creation of employment opportunities and paying taxes and other dues honestly to the government are the national objectives of a business.
   (e) A businessman should prepare a false statement of accounts in order to save taxes.
   (f) Profit plays no role in business.
3. Identify the causes of business risk in the following causes :
   i. X Ltd. suffered a loss due to bursting of boiler.
      a) Natural Cause b) Political Cause
      c) Physical Cause d) Economic Cause
   ii. Auditor identified misappropriation of cash by a group of workers in Y Ltd.
      a) Natural Cause b) Human Cause
      c) Physical Cause d) Political Cause
   iii. Suzuki Ltd. suffered a loss due to tsumami
      a) Natural Cause b) Human Cause
      c) Economic Cause d) Political Cause

1.5 CLASSIFICATION OF BUSINESS ACTIVITIES

Let's look around and find out the various types of business activities that usually take place in an economy. Some of these are:

- extraction of oil, natural gas or minerals;

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- manufacturing of commodities;
- buying of goods from one place/country and selling it at different place/country;
- construction of buildings, roads, and bridges etc.
- providing services like ticketing, warehousing, transportation, banking, insurance etc.

When we analyse the above business activities we find that most business activities are concerned with production and/or processing of goods and services or distribution of goods and services. The former is known as 'Industry' and the latter as 'Commerce'. So we can classify business as Industry and Commerce. Let us now know details about these two categories.

1.6 INDUSTRY

Industry primarily refers to all such business activities concerned with production/raising or processing of goods and services. It processes raw materials or semi-finished goods into finished goods. Extracting raw materials from earth's surface, manufacturing goods and commodities, producing crops, fish, flowers, etc., constructing buildings, dams, roads etc. are all examples of industry. These activities are called industrial activities and the units engaged in these activities are known as industrial enterprises. However in a broader sense, provision of services like banking, insurance, transport also form part of industries known as tertiary industries.

Classification of Industries

Before classifying industry on the basis of nature of activity, let us have a broad idea of different approaches of its classification.

On the basis of nature of activity	*On the basis of nature of goods produced*	*On the basis of level of investment*	*On the basis of size of activity*
(a) Primary	(a) Consumer goods industries	(a) Heavy industries industries	(a) Small scale industries
(b) Secondary industries	(b) Producers' goods or Capital goods	(b) Light industries industries	(b) Large Scale industries
(c) Tertiary industries			

Let us now discuss in detail about the classification of industry based on nature of activity involved.

(a) **Primary Industries :** Primary industries refer to the activities of extraction of natural resources like coal, oil, minerals etc. and reproduction and development of living organisms like plants and animals etc. Primary industries can be categorised as extractive and genetic industries. You must have heard about ONGC – it is a company that extracts oil and natural gas from earth. Similarly we have farmers growing crops, business houses engaged in extracting raw materials/minerals from earth (coal-mines, iron-ore mines etc.), extracting materials from forest for further processing (like collecting natural honey, timber etc.), extracting items from sea/ river (like fish, crab, prawn, sea foods etc.). All these are examples of extractive industries.

Have you seen poultry farms, or apple orchards or nurseries? All these are industries engaged in rearing and breeding animals and birds and growing plants or flowers for sale and are known as genetic industries. Now-a-days genetic industries are growing in number which include Horticulture (growing fruits and vegetables), Floriculture (growing flowers), Dairy Farming, Poultry Farming, Pisiculture (breeding fish) etc.

(b) **Secondary Industries :** The products of primary industries are normally used as raw materials to produce a variety of finished goods. And it is the secondary industry that uses the products of primary industry as its raw materials. The activities of secondary industries may be of manufacturing or construction. Manufacturing industries are engaged in producing finished goods out of raw materials or semi-finished products. For example, cotton is used to produce textile, timber to produce furniture, bauxite to produce alumina. The industries engaged in erection of buildings, dams, bridges, roadways, railways, canals, tunnels etc. are known as construction industries. They make use of the products of other industries and construct different types of structures as per the requirements of the customers.

(c) **Tertiary Industries :** These industries are basically concerned with generating or processing of various services and facilitate the functioning of primary industries and secondary industries as well as activities of trade. These include service industries like banking, insurance, transport etc. Film industry which provides entertainment to the individuals, produces films; tourism industry which provides services to the individual by facilitating their travel, booking of tickets and hotel rooms etc. are also included in this category.

Manufacturing industries may be divided further into the following categories:

(i) **Analytical Industries** manufacture different types of products by analysing and separating different elements from the same product. Petrol, diesel, kerosene, lubricating oil etc. are produced from the crude oil in oil refinery industry.

(ii) Synthetic Industries put together various ingredients and manufacture a new product. For instance, soap is produced by combining potassium carbonate and vegetable oil. Similarly, cement is produced by using limestone, coal and other chemicals.

(iii) Processing Industries are those in which raw materials are processed through successive stages to get the final products. Textile, sugar and paper are the examples of processing industry.

(iv) Assembling Industries put together various manufactured products and make a new product as in the case of car, scooter, bicycle, radio and television etc.

Classification of Industries
(Based on nature of activity)

- Primary Industries
  - Extractive Industries
  - Genetic Industries
- Secondary Industries
  - Manufacturing Industries
  - Construction Industries
- Tertiary Industries
  - Transportation
  - Warehousing
  - Insurance
  - Banking
  - Communication
  - Advertising

INTEXT QUESTIONS 1.4

1. Below are given certain groups of industries. In each group, one industry does not match with the group. Find out that industry and underline it. The first one has been done for you. In this all industries except textile belong to extractive industries.

   (a) Agriculture, forestry, <u>textile</u>, fishery.

   (b) Dams, roads, canals, cement.

   (c) Poultry farming, hunting, mining, forestry.

   (d) Iron & steel, textile, chemical works, pisiculture.

   (e) Oil exploration, agriculture, dairy farming, hunting.

   (f) Floriculture, films, transport, banking.

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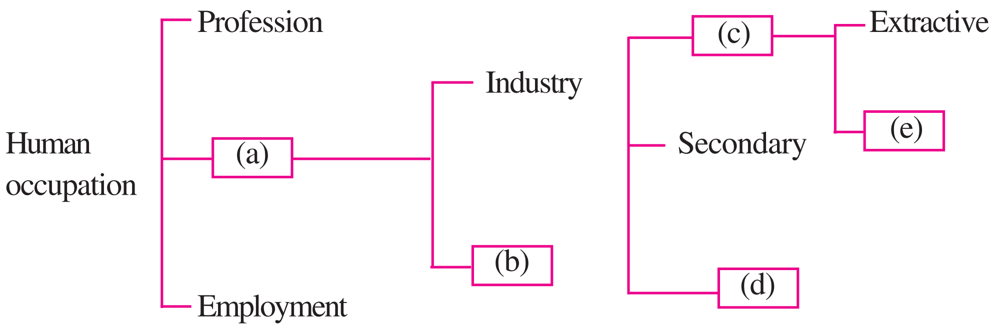
2. Complete the following Chart:



1.7 COMMERCE

All goods and services produced are to be made available by those who need them. This involves a number of additional activities. For example when somebody produces bread, he has to make it available at convenient locations at right time. This involves activities like making people aware about the product, storing the product at right places, arranging retail outlets, packaging the product, transportation of the product, selling the product and so on. All these activities taken together are known as Commerce. It provides the necessary link between producers and consumers of goods and services and facilitates the purchase and sale of goods and services. In fact, it performs all functions, that are essential for maintaining a smooth and uninterrupted flow of goods and services to the customers. Thus, commerce involves:

(a) Buying and selling of goods and services; and

(b) Activities essential for the smooth and uninterrupted flow of goods and services from the point of production to the point of consumption.

The first activity, that is, purchase and sale of goods and services is termed as Trade, and the second activity i.e., the activities that ensure smooth flow of goods to customers are known as 'Auxiliaries to trade' or 'Aids to trade'. Thus, commerce is classified as:

(1) Trade; and

(2) Auxiliaries to trade.

Let us know in detail about the above two activities of commerce.

1.7.1 Trade

Trade is an integral part of commerce. It simply refers to sale, transfer or exchange of goods and services. It helps in making the goods and services available to ultimate consumers. The manufacturers of goods who produce in bulk or large quantity generally find it very difficult to sell those goods directly to the consumers. The reasons may be distance of the consumers from the place of manufacturing, or the quantity of the product bought at one point of time, the problem of payment and so on. Hence they utilise the services of some firms or individuals who buy goods from the manufactures and sell it to the consumers. For example, the local grocery shop owner sells grocery items to the consumers after buying it from the manufactures. Sometimes, he buys it from the wholesalers who buy goods in bulk from the manufactures and sell it to him. It may be noted that the wholesalers as well as the grocery shop owners are said to be engaged in trading. Thus, the features of trade can be summed up as follows:

(a) It involves actual buying and selling of goods;

(b) It refers to procuring goods from one place/person to sell it to another person or at another place;

(c) Traders, also known as middlemen facilitate the distribution of goods;

(d) Trading helps in equalising demand and supply. For example, the state of Punjab may be producing plenty of rice without much demand for it in its own state. Traders buy rice from Punjab and make it available to states like Orissa and West Bengal where there is a great demand for rice. Thus, the demand and supply ratio is maintained.

On the basis of area of operation, trade can be classified as under –

(a) Internal Trade; and

(b) External Trade.

(a) Internal Trade : When trade takes place within the boundaries of a country it is called internal trade. It means both the buying and selling take place within the country. For example, a trader can buy woolen garments from the manufacturers at Ludhiana and sell it to the retailers in Delhi. Similarly a trader of a village can buy goods from the wholesale market of a city for sale in the village. From these two examples, we find that internal trade can be (a) buying from manufactures and selling it to retailers in bulk (known as wholesale trade); or (b) it can be buying from manufacturers or wholesalers and selling it to consumers (known as retail trade).

(b) External Trade : Trade that takes place between different countries is known as external trade. In other words, external trade refers to buying and/or selling of goods/services across national boundaries. This may take any of the following forms:

(i) Firms of country 'A' purchase goods from firms of county 'B' to be sold in their own country. This is known as Import trade.

Notes

(ii) Firms of country 'A' sell goods produced in their own country to firm of country 'B'. This is known as Export trade.

(iii) Firms of country 'A' purchase goods from firms of country 'B' to be sold to firms of country 'C'. This is known as Entrepot trade.

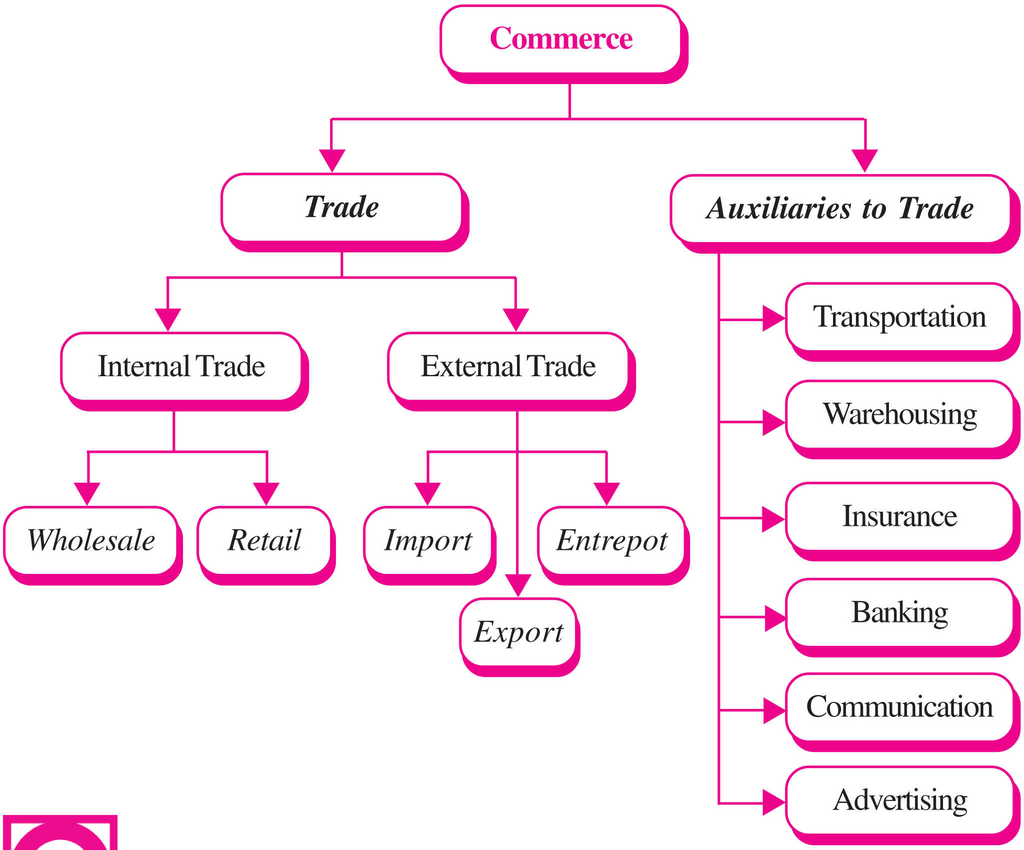
1.7.2 Aids/Auxiliaries to Trade

To facilitate buying and selling of goods (trade) a variety of other activities are required to be performed. These include, transport of goods, storage of goods, financial transactions, insurance of goods etc. For example, when a company at Chennai buys goods from Delhi or imports it from Singapore, it needs to undertake most of the following activities, in addition to buying and selling of goods. These activities are–

- Carrying of goods physically from Delhi/Singapore to Chennai (called **Transportation**)
- Systematic storage of goods once the goods are received at Chennai (called **Warehousing**).
- Arranging money and making payments to the seller through banks and other sources (called **Banking**).
- Covering risk of damage/loss of goods in transit from Delhi/Singapore or while it is in store (called **Insurance**)
- Exchange of information with each other through postal and telecom services (called **Communication**).
- **Advertising :** In today's competitive market, it is not possible for a businessman to sit and wait for customer after investing heavily in business. To attract customers towards his product, a producer has to provide full knowledge of his product to the customer. Advertising does this properly. Advertisement enhances the knowledge of the customer about the products available in the market and with the help of this knowledge, a customer takes decision about the purchase of the product. In this way, advertisement enhances the knowledge of the customers and eliminates the hindrance of information.

All the above activities help in facilitating the trading activities or providing support to the trading activities. That is why these are called auxiliaries to trade. So auxiliaries to trade refer to those activities that facilitate trade. These activities not only facilitate the trading activities, but also provide the necessary support to the entire business in its successful functioning. Hence, these are also called support services of business. In the next lesson we shall discuss about all these support services of business in detail.

Classification of Commerce



INTEXT QUESTIONS 1.5

1. Give one word substitute for the following sentences:

   (a) The process of exchange and distribution of goods and services.

   (b) Buying and selling of goods and services.

   (c) Buying and selling of goods in large quantities.

   (d) Import of goods for exporting.

   (e) Buying and selling of goods between different countries.

2. Complete the following incomplete words by taking clues from the statements given for each. Every blank represents one letter only. First one has been done for you.

   (a) __ __ M M __ __ C __ (COMMERCE)

   (b) __ __ A __ E

   (c) W __ __ __ H __ __ __ I N __

(d) __ X __ __ __ T

(e) E __ __ __ E __ __ T

(f) __ H __ __ E __ __ __ E

(g) __ __ T __ __ L

Clues:

(a) All activities that facilitate availability of goods and services for consumption.

(b) Buying and selling of goods.

(c) Storage of goods whether raw material or finished goods.

(d) Selling of goods to foreign countries.

(e) A company of one country buys goods from a company of another country to be sold to a company of some third country.

(f) Goods are bought and sold in bulk quantities.

(g) Goods are sold in small quantities to consumer.

Notes

WHAT YOU HAVE LEARNT

- Human beings undertake various activities to satisfy their needs and wants. These activities are known as Human Activities.
- Human activities that are undertaken with an objective to earn the livelihood are called Economic Activities.
- Activities undertaken to derive mere satisfaction are known as Non-Economic Activities.
- All activities that require special knowledge and skill to be applied by an individual to earn a living are known as Profession.
- When people render their services regularly for others and get the return in terms of wages/salary, we call it Employment.
- Activities involving regular production or purchase of goods and services for sale, transfer and exchange with an object of earning profit are known as Business.
- Earning of adequate profits, exploring new markets, growth and expansion of business, innovation and optimum utilisation of available resources are the Economic objectives of a business.

- Social objectives of a business include production of quality goods, reasonable pricing, general welfare and upliftment of the society, fair dealings and good return to the investors.
- Human objectives include fair remuneration and incentives to the employees, better working conditions, job satisfaction, training, development and promotional opportunities etc.
- National objectives of a business are creation of employment opportunities, social justice, national interest and priorities, and payment of taxes to the government honestly.
- Global objectives of a business include making available globally competitive goods/services and reducing the gap between rich and poor nations by way of expansion of business.
- Profit is needed for survival, future growth and expansion, creating prestige, achieving goals and to measure the efficiency of business firm.
- Business risk means chance of loss due to happening of uncertain events in future.
- Business risk is uncertain, difficult to measure, variable and an essential element of business.
- Business risks arise due to natural, economic, political, human, physical and technical causes.
- Industry refers to production/raising or processing of goods and services. On the basis of nature of activity it is divided into primary, secondary and tertiary industries.
- Primary industry is concerned with extraction of natural resources, and reproduction and development of living organisms. It can be classified as extractive and genetic industries.
- Secondary industry uses the products of primary industry as its raw material. It can be either manufacturing or construction.
- Manufacturing industries are engaged in producing finished goods. It can further be classified as Analytical, Synthetic, Processing and Assembling Industries.
- Tertiary industries are concerned with generating and processing various services to the customers.
- Commerce is the sum total of all activities involving removal of hindrances in the process of exchange of goods and services and facilitates the availability for consumption. So it consist of trade and other support services that facilitate trade.

- Trade refers to the process of buying and selling of goods and services. When trade takes place within the boundaries of a country, it is called Internal trade. It is called Wholesale trade when goods are bought in bulk from manufacturers/ produces and sold in bulk to retailers. It is termed as retail trade when goods are bought from manufacturers or wholesalers and sold in small quantities to consumers. Trade that takes place between two countries is known as External trade. When goods are purchased from a foreign country, it is known as Import trade. Export trade is the process of selling goods to a foreign country. When goods are bought from one foreign country to be sold in some other foreign country it is known as Entrepot trade.
- Auxiliaries to trade are various activities that facilitate trade. They are Transport (carrying goods physically); Communication (gathering and sharing information); Warehousing (storage of goods); Banking (making arrangement of funds and facilitate its transaction); Insurance (opting for insurance to avoid the risk of loss); and Advertising (Communicating information to the consumers).

KEY TERMS

Advertising	Enterpot Trade	Processing Industry
Analytical Industry	Export Trade	Profession
Assembling Industry	Extractive Industry	Retail Trade
Auxiliaries to Trade	Genetic Industry	Secondary Industry
Banking	Human Activity	Synthetic Industry
Business	Import Trade	Tertiary Industry
Commerce	Industry	Trade
Communication	Insurance	Transport
Construction Industry	Internal Trade	Warehousing
Economic Activity	Non- economic Activity	Wholesale Trade
Employment	Primary Industry	

TERMINAL EXERCISE

Very Short Answer Type Questions

1. What is meant by 'human activity'?

2. Define the term ‘occupation’.
3. Distinguish between consumer goods and capital goods.
4. State the meaning of ‘Genetic industry’.
5. What is ‘Trade’?
6. Enumerate two physical causes of business risks.
7. List two examples of human causes of loss in business.

Short Answer Type Questions

8. Explain the different type of primary industries.
9. How would you classify business activities?
10. Distinguish between economic and non-economic activities.
11. State any two characteristics of business.
12. Mention any three economic objectives of business.
13. Mention any three characteristics of business risks.
14. Briefly describe physical causes of business risks.

Long Answer Type Questions

15. Describe the importance of business in modern society.
16. What is meant by profession? Explain its features in brief.
17. Explain the various human objectives of business.
18. State the meaning of ‘Industry’. Explain the various classifications of industry.
19. Define the term ‘Commerce’. Describe the various activities relating to commerce.
20. Explain the role of profit in business.
21. What do you mean by business risk? Explain the natural causes of business risks.
22. Describe the causes of business risks.
23. **“Profit plays the same role in business as blood plays in human beings.” Give your comments in the light of this statement.**
24. **Your friend Ramesh wants to starts a business. Therefore, he is interesting to know the business risks and their causes. Explain him the meaning and causes of business risks.**

Notes

ANSWERS TO INTEXT QUESTIONS

1.1 1. All such activities that are performed with an object of earning money or livelihood are called economic activities.

2. (a) A person working in a school garden.
(b) A lady preparing food in a restaurant.
(c) A man white-washing the building of a trade centre.
(d) A teacher teaching students in a school.
(e) A chartered Accountant preparing accounts of a firm.

1.2 2.

Business	Profession	Employment
(d) (e) (f)	(i) (j)	(a) (b) (c) (g) (h)

1.3 1.

If he chooses	What should he do?	What will he get as return?
(a) Business	May open a chemist shop **or** Start a company to manufacture medicines	Profit
(b) Profession	Start his own clinic	Fee
(c) Employment	Get the job in a hospital	Salary

2. (a) Business maximises opportunities to work and thus, generates employment in the country.
(b) By producing and exporting quality goods and services, the national image of a country improves.
(c) Business objectives should not concentrate only on profit earning.
(d) No correction required
(e) The businessmen should prepare the true statement of accounts and the pay the taxes honestly.
(f) Profit plays an important role in business.

3. (i) c (ii) b (iii) a

1.4 1. (b) Cement (c) Poultry farming (d) Pisiculture
(e) Dairy farming (f) Floriculture

2. (a) Business (b) Commerce (c) Primary (d) Tertiary (e) Genetic

1.5 1. (a) Commerce (b) Trade (c) Wholesale trade
(d) Entrepot (e) External trade

2. (b) TRADE (c) WAREHOUSING (d) EXPORT
(e) ENTREPOT (f) WHOLESALE (g) RETAIL

DO AND LEARN

Make a list of atleast 10 business enterprises of your locality. Classify them as industry, trade and auxiliaries to trade. Take a note of the nature of their activity and prepare a chart.

ROLE PLAY

1. Rameshwar's son, Rampal wants to become a government servant. He is not supported by his father who wants Rampal to start his own business. Following is a begining of the discussion between Mr. Rameshwar and his son Rampal.

Rameshwar : Beta! I want you to be independent in life. So start doing some business.

Rampal : Papa! I am more concerned about my personal satisfaction in my career rather than being independent. I want to be a public servant.

Rameshwar : Listen to me, there is nothing like satisfaction. Business will give you more money and status. Please, be practical in life.

Rampal : Papa! I have always given money second preference in life. It would be more satisfying to serve the public honestly.

Choose a role for yourself and one for your friend and give your arguments in favour of, or against the protagonists in the example.

(You are free to select any other concept covered in this lesson to develop your own script. Start playing your roles and enjoy your study).

2. Sameer is interested to start a business in the field of service industry. His friend Manya told him that there were so many opportunities in this field.

Sameer : Manya! I want to start a business in the field of service industry.

Manya : Very good, Sameer. This is a good idea. I have studied in my book of Business Studies that there are so many opportunities available in the field of service industry.

Sameer : Please tell me about these opportunities.

Choose a role for yourself and one for your friend and continue this conversation to explain the various types of service industry.

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2

BUSINESS SUPPORT SERVICES

Have you ever observed the various activities performed by a businessman while carrying out the business operations? Look at the grocery shop of your locality. What does the owner do? He arranges funds, buys goods from the main market, carries those goods to his shop, stores those systematically and sells to the customers as per their demand. While doing all these activities the owner or the businessman needs various help or support from others. For example, he may take loan from bank, hire a tempo or truck in carrying the goods and so on. Thus, to carry out any business activity successfully various support services are required. Let us have an idea about those services and their operations. In this lesson we shall learn about the basic aspects like the meaning, importance and functioning of these support services.

OBJECTIVES

After studying this lesson you will be able to:

- explain the concept of business support services;
- identify various types of services;
- explain the importance of banking;
- identify different types of banks and the functions of a commercial bank;
- explain the importance and types of insurance;
- describe the meaning, importance and modes of transportation;
- explain the concept of communication, its importance and various means used for communicating;
- describe the meaning and importance of warehousing;

Notes

- identify the various types of warehouses; and
- explain the functions of warehouses.

2.1 BUSINESS SUPPORT SERVICES

As stated earlier, the business support services refer to those business activities that act as auxiliaries to trade and facilitate smooth flow of goods from producer to consumer and the functioning of business as such. These include banking, insurance, transportation, warehousing and communication. Banking helps in providing finance and payment facilities, insurance to provide a cover to all sorts of business risks, transportation to facilitate physical movement of goods from one place to another, warehousing to provide storage facilities at various places to meet seasonal variations in demand, and communication for facilitating exchange of information and ideas between producers, middlemen and consumers. Thus, effectively, these business services are essential for smooth functioning of any business in any part of the world, and every person who is engaged in business must be fully aware of their functioning and use. Let us now learn about each one of these in detail.

INTEXT QUESTIONS 2.1

1. State the meaning of 'Business Support Services'.
2. Name the support service required in the following business activities.
   (a) Movement of goods and services.
   (b) Providing finance and payment facilities.
   (c) Coverage of business risks.
   (d) Storage of goods and making them available on demand.
   (e) Exchange of information and ideas.

2.2 BANKING

Bank is an institution that deals in money and credit. It accepts deposits from those who have funds to spare and grants loans and advances to those who are in need of funds for various purposes. Thus, banking refers to the various services provided by banks, such as acceptance of deposits, grant of loans and advances, and other supplementary services. Banking Regulation Act defines banking as "accepting, for the purpose of lending or investment of deposits of money from the public repayable on demand or/and withdrawable by cheque, draft or otherwise". Thus, acceptance of deposits and lending or investing the same are two essential functions of a bank who act as an intermediary and deals with money belonging to the public. Of course, it provides many other financial services as clarified later in this chapter.

Notes

2.2.1 Importance of Banking

(a) **Capital Formation :** Deposits accepted by banks are channelised as loans and advances for industrial and trading activities to business organisations. Thus, banking indirectly converts savings into investment leading to capital formation and development of economy.

(b) **Services to Business :** Banking helps business through a variety of services such as providing long-term and short-term finance, arranging remittance of money, collection of cheques and bills etc., assisting in raising of capital by acting as underwriters and merchant bankers and so on.

(c) **Reduces Use of Currency :** Banks enable depositors to make payment by cheque, which is transferable by endorsement and delivery. Besides, travellers can carry travellers' cheques, credit cards etc. issued by banks instead of liquid money. Thus, use of currency is considerably reduced.

(d) **Mobilisation of Savings :** Banks allow savings to be deposited in different types of accounts such as Current Account, Savings Bank Account, Fixed Deposit Account, etc. The facilities of withdrawal as and when desired, and payment of interest on deposits encourage people to save money and put it in the banks.

(e) **Benefits to Rural Economy :** Rural branches of banks play a useful role in mobilising savings in rural areas and provide loans to farmers and artisans at concessional rates and on priority basis. This helps the rural economy in a big way.

(f) **Balanced Development of Economy :** Banks identify areas that need special assistance for industrial development and provide them the necessary help. Similarly they also identify backward regions and help in their economic development by providing them adequate funds at reasonable rates. Banks thus, help backward areas in industry and balanced regional development.

(g) **Development of Credit Policy :** Credit policy is a pre-requisite for economic development. The central bank of a country develops a proper monetary policy by determining the bank rate and regulate the money supply in the larger interest of the economy and the pace of its development.

2.2.2 Types of Banks

There are various types of banks operate in our country to meet the diverse financial needs of customers. One may need money for short period of time, whereas others need it for longer period. A businessman may require funds for trading purposes whereas another may need it for setting up of a big manufacturing unit. Sometimes government also needs money and credit. So to meet all these needs we have different types of banking institutions, which can be categorised as per their functions.

(a) Commercial bank (b) Co-operative bank

(c) Development bank (d) Specialised bank

(e) Central bank

Now let us have an idea about all these banks.

(a) Commercial Bank : Commercial Banks are banking institutions that accept deposits from the public and grant short-term loans and advances to their customers. Now-a-day, the commercial banks have also started giving medium-term and long-term loans to trade and industry. Commercial banks may be (i) public sector banks, (ii) private sector banks, or (iii) foreign banks.

(i) Public Sector Banks : In public sector commercial banks, the majority stake is held by the Government of India or Reserve Bank of India. Examples of such banks are: State Bank of India, Bank of Baroda, Syndicate Bank, Dena Bank, etc.

(ii) Private Sectors Banks : In case of private sector banks, the majority of share capital of the bank is held by private individuals. These banks are registered as public limited companies. Example of such banks are: Jammu and Kashmir Bank Ltd., Lord Krishna Bank Ltd., ICICI Bank Ltd. Kotak Bank, HDFC Bank Ltd. etc.

(iii) Foreign Banks : These banks are incorporated in foreign countries and operate their branches in our country. Example of such banks are: Hong Kong and Shanghai Banking Corporation (HSBC), Citibank, American Express Bank, Standard & Chartered Bank, ABN-AMRO Bank, etc.

(b) Co-operative Bank : When a co-operative society engages itself in banking business it is called a Co-operative Bank. . The co-operative banks generally grant loans for productive purposes as well as for other purposes. The rate of interest charged is usually low. These banks are also subject to control and inspection by Reserve Bank of India. There are three types of co-operative banks operating in our country. These are: (i) Primary Credit Societies (ii) Central Co-operative Banks, and (iii) State Co-operative Banks.

(c) Development Bank : Development banks are the financial institutions which provide medium and long-term loans to industry. Rapid development of industries in India after independence requiring huge financial investment and promotional efforts led to the establishment of these institutions. Development banks assist the promotion, expansion and modernisation of industries. Besides providing medium and long-term finance, these banks also subscribe to the capital issues of industrial undertakings. They also provide technical advice and assistance, if needed. Industrial

Finance Corporation of India (IFCI) and State Financial Corporations (SFCs) are examples of development banks in India.

(d) **Specialised Bank :** There are some banks which engage themselves in some specific area or activity and are thus, called specialised banks. Export Import Bank of India (EXIM Bank), Small Industries Development Bank of India (SIDBI), National Bank for Agricultural and Rural Development (NABARD) are examples of such banks.

(e) **Central Bank :** In every country a bank which is entrusted with the responsibility of guiding and regulating the banking system is known as the Central Bank. Such bank is an apex bank and acts as the highest financial authority. In India, the central banking authority is the Reserve Bank of India. It does not deal directly with the members of public. It acts as bankers' bank, maintains deposit accounts of all other banks and advances money to banks as and when needed. It regulates the volume of currency and credit, and has the powers of control and supervision over all banking institutions.

The Reserve Bank of India also acts as government banker and maintains the record of government receipts, payments and borrowings under various heads. It advises the government on monetary and credit policy, and plays an important role in fixation of the rate of interest on bank deposits and bank loans. It is the custodian of currency reserves consisting of foreign exchange, gold and other securities. Another important function of the Reserve Bank of India is the issue of currency notes and regulation of the money supply.

2.2.3 Functions of Commercial Bank

The functions of a commercial bank are divided into two categories viz. (a) primary functions; and (b) secondary functions. Let us understand the nature and variety of those functions more clearly.

(a) Primary Functions

The primary functions of a commercial bank include: (i) accepting deposits; and (ii) lending money.

(i) **Accepting Deposits :** The most important activity of a commercial bank is to accept deposits from the public. People who have surplus income and savings find it convenient to deposit it with banks. For the convenience of the customers, banks provide different types of deposit accounts like Fixed Deposit Account, Recurring Deposit account, Current Account, Savings Bank Account, etc. with varying rates of interest. Public is also assured of the safety of funds deposited with the bank.

(ii) Lending Money : The second important function of a commercial bank is lending of money to the public as well as to the business houses. It takes the form of loans and advances to the customers at the prescribed rates of interest. Loans are granted for a specific period. The borrower may be given the entire amount in lump sum or in instalments. Loans and advances are generally granted against the security of certain assets. The credit facility granted by the banks is usually for a shorter period of time which takes the form of cash credit, overdraft or discounting of bills. As stated earlier, banks also provide loans for a medium term or a long period.

(b) Secondary Functions

Besides the two primary functions outlined above, the commercial banks also render a number of ancillary services. These services supplement the main activities of the banks and may be termed as secondary functions of commercial banks. They are essentially non-banking in nature and broadly fall under two categories: (i) Agency services; and (ii) General utility services.

(i) Agency Services: Agency services refer to those services which are provided by commercial banks as agents of their customers. These include:

- Collection and payment of cheques and bills;
- Collection of dividends, interest and rent, etc.;
- Purchase and sale of securities (shares, debentures, bonds etc.);
- Payment of rent, interest, insurance premium, subscriptions etc.;
- Acting as a trustee or executor; and
- Acting as agents or correspondents on behalf of customers for other banks and financial institutions at home and abroad.

(ii) General Utility Services: General utility services are those services which are rendered by commercial banks not only to the customers but also to the general public. These are available to the public on payment of a fee or charge. These include:

- Issue of bank drafts, pay order (banker's cheque), travellers' cheques;
- Issue of letters of credit;
- Safe-keeping of valuables in safe deposit locker;
- ATM card, debit card and credit card facility;
- Internet banking and phone banking;

- Sale of prospectus and application forms of various competitive examinations;
- Accepting telephone bills, electricity bills;
- Underwriting loans floated by government and public bodies;
- Supplying trade information and statistical data useful to customers; and
- Acting as a referee regarding the financial status of customers.

2.2.4 Types of Bank Accounts

1. **Saving Deposit Account :** These deposits are aimed to encourage habit of savings among people. Saving Account can be opened with a small amount, say Rs. 100. Deposits can be made any number of times in this account. However, there are restrictions on withdrawals. Interest is allowed on minimum daily balance. Rate of interest is allowed on these deposits is lower than that on FDs. A passbook is issued to the account holder which indicates the amount deposited and withdrawals made as well as the balance in the account holder's account.

2. **Current Deposit Account :** Current Deposit Account provides facilities to industrialists and businessmen to deposit or withdraw the money as and when they need. Money can be withdrawn at anytime by means of cheque. There is no restriction on making deposits in such account. No interest is allowed on this account balance. However, overdraft facilities are provided on current accounts. Current deposits are also called 'Demand Deposits' as they are payable on demand by the depositors. A passbook is also issued to the account holder.

3. **Fixed Deposit Account :** A fixed amount is deposited for a specified time period in case of a Fixed Deposit (FD) Account. e.g. one year, three years, five years etc. After the expiry of the fixed period, the deposit is repayable with interest. A higher rate of interest is offered on fixed deposits. The rate of interest varies with the period of deposit. Fixed Deposits are also called 'time Deposits' or 'Long-term Deposits'. Banks do not provide passbook and cheque book facilities on fixed deposit accounts. The rate of interest in fixed deposit is more than the rate of interest in saving account and depends on the duration for which deposits have been made.

4. **Recurring Deposit Account :** In Recurring Deposit Account, the account holder is required to deposit a specified sum of money every month for specified time period e.g., five years, seven years, ten years etc. At the end of the period, the accumulated amount together with interest earned is paid to the account holder. Withdrawals before maturity not allowed. In this type of account, cheque book facility is not available to account holders. Recurring deposits also called 'cummulative time deposits'. A passbook issued to account holder showing the

deposit made every month. Recurring deposit account used by small savers. Rate of interest offered by bank on recurring accounts is more than the rate of interest on saving account.

2.2.5 Banking Services

Commercial banks offer variety of services in addition to accepting deposits and lending money. Such services are as under :

1. **Issue of Bank Draft :** Bank draft is a convenient and safe mode of remitting money from one place to another. It is an order to pay a certain sum of money to the payee or order by the issuing bank to it's another branch. For remitting money the following procedure is followed.

    a) Person who wants to remit money fills in a form and pays the amount of draft along with the prescribed commission to the bank.

    b) Bank gives him the bank draft.

    c) He then sends the bank draft to the payee by post or courier service.

    d) Payee deposits it in his bank.

    e) Bank collects the payment form the issuing bank and credits the same to the payee's account.

    Features of Bank Draft

    a) There is no risk of dishonour of a bank draft.

    b) The issuing bank charges some commission for bank draft.

    c) Bank draft is a safe and convenient method to transfer money from one place to another.

    d) A bank draft is valid for three months from the date of its issue.

    e) It contains an order to pay a certain sum to the payee or his order.

2. **Banker's Cheque (Pay Order) :** A pay order is like a bank draft, but it is payable at the issuing branch. Therefore it is used to send the money within the city. It is also called as a local bank draft. The commission charged for a pay order is lesser than that charged for a bank draft. Like a bank draft a pay order is also valid for three months from the date of its issue.

3. **Real Time Gross Settlement (RTGS) :** RTGS is a funds transfer system. In this system, transfer of funds take place from one bank to another on a 'Real Time' and 'Gross' basis. i.e., there is no waiting period in payment. The settlement of transaction is done as soon as it is processed. 'Gross' settlement means the

transactions is made on one to one basis without bunching with any other transaction. The receiving bank must credit the customer's account within 2 hours of receiving the funds transfer message. The minimum amount in RTGS transaction is Rs. 50,000. There is no upper ceiling for a RTGS transaction. Fees charged for RTGS transactions vary from bank to bank.

4. **National Electronic Funds Transfer (NEFT) :** NEFT is a fund transfer system. In NEFT an individual, firm or company can electronically transfer funds from any bank branch to another individual, firm or company having an account with any other bank in the country. The funds transfer takes place at a particular period of time. During week days NEFT transactions take place 6 times a day (9.30a.m, 10.30 a.m., 12.00 noon, 1.00 p.m., 3.00 p.m., and 4.00 p.m.) on Saturday NEFT transactions take place 3 times a day (9.30 a.m., 10.30 a.m., and 12.00 noon)

   Features of NEFT

   a) An individual, firm or company can make use of NEFT even without having a bank account by depositing cash at a NEFT enabled bank branch.

   b) In order to receive funds through the NEFT system, an individual firms or company must have an account with a NEFT enabled bank branch.

   c) NEFT transaction take place in batches.

   d) If one does not have a bank account, the maximum amount that can be transferred through NEFT system is Rs. 49,999.

   e) There is no minimum or maximum amount that can be transferred through NEFT when one has bank account.

   f) NEFT is not used to receive foreign remittances.

   g) The sender of funds must pay charges for NEFT. The amount of charges vary according to the amount sent.

   h) The receiver of funds has not to pay any charges.

5. **Bank Overdraft :** Current account holder is allowed to draw by cheque more than the amount to his credit up to a specified limit. This facility is provided against the security of some assets. A higher rate of interest is charged on bank overdrafts. Extra amount withdrawn from the current account must be deposited in the account within the prescribed period.

6. **Cash Credit :** Under cash credit system, person, firm or company can borrow money from the bank. Money can be borrowed up to a specified limit. The borrower withdraws money as and when required. Interest is charged on the amount withdrawn by the borrower. Cash credit limit is decided by the bank on the basis of the borrower's assets and personal reputation.

Notes

7. **SMS Alerts :** It is a type of e-banking facility. To avail this service, the customer must get his/her mobile number registered with the bank. The Bank records the mobile number of customer in computer system in the profile of customer. Whenever a transaction takes place in the customer's account, there is a SMS alert on his mobile phone. SMS alerts give information of the up to date balance in his account without visiting the bank.

2.2.6 E-Banking

Internet banking/Electronic banking means performing banking transactions with the help of computer systems. Any user with a Personal Computer (PC) and a browser can get connected to the banks website to perform any banking functions. Any user can avail of banking services with the help of internet. e.g. a customer withdraws money through an ATM (Automated Teller Machine)

Benefits

i. Customers get 24 hours and 365 days services.

ii. Unlimited access to the bank increases customer satisfaction.

iii. E-banking facilitates customers to do banking transactions while travelling.

iv. E-banking lowers the transaction costs.

v. E-banking empowers customers.

vi. E-banking provides competitive advantage to the bank.

Range of services offered by e-banking are :

i. Electronic Funds Transfer (EFT),

ii. Automated Teller Machines (ATM),

iii. Point of Sales (POS)

iv. Electronic Data Interchange (EDI) and

v. Digital Cash

2.2.7 Postal and Telecom Services

Parcel Post

Parcels of specified size and weight can be sent through post. Postal charges for parcels vary according to the weight of the parcel, distance etc. Using parcel post, articles are sent across the country as well as outside the country.

Courier

Courier services are offered by private sector enterprises. Letters, products in small quantity etc. are sent from one place to another by availing courier service.

Notes

Saving Services

1. **Recurring Deposit (RD) in Post Office :** In this scheme a certain amount of money is deposited every month for a specified time period. (e.g., 5 yrs. 10 yrs. etc). Total amount deposited together with interest is repaid on maturity. The main objective of RD is to accumulate small savings. Cheque facility is not provided. But passbook is issued to the account holder. The amount becomes payable on the maturity, however loan may be provided against the security of the recurring deposit account.

2. **National Saving Certificates (NSC) :** NSC is taken for any amount of Rs. 100 and more. The term is for 5 years or 10 years. At the end of period, the amount of NSC together with interest is paid to the deposit holder. Tax benefit is available for funds invested in NSC, subject to an overall limit of Rs. 1,00,000.

3. **Public Provident Fund (PPF) :** An adult can open a PPF account by depositing every year an amount in between Rs. 500 – Rs. 1 lakh in some specified banks or in a post office. The term of a PPF account is 15 years. Which can be extended for a further period of 15 years. Funds invested in PPF are eligible for tax benefit under Sec. 80C of the Income Tax Act, 1961. A passbook showing the deposit details is issued to the account holder.

4. **Monthly Income Scheme (MIS) :** An Indian can open a Monthly Income Scheme in single name or jointly with another person. Deposit is made one time up to Rs. 4.5 lakhs (incase of single name account) and Rs. 9 lakhs (in case of joint account). Interest is paid monthly to the account holder. At the end of five years, the deposit amount paid to the account holders. A passbook is issued to the account holder. Premature withdrawals are not allowed.

INTEXT QUESTIONS 2.2

1. Name the bank which is termed as bankers' bank.

2. Categorise the following under agency and general utility services of commercial banks.

   (a) Purchase and sale of securities.

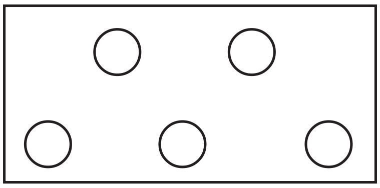
   (b) Issue of letter of credit.

   (c) Issue of bank drafts.

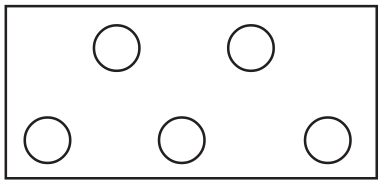
   (d) Internet Banking

   (e) Collection of dividends

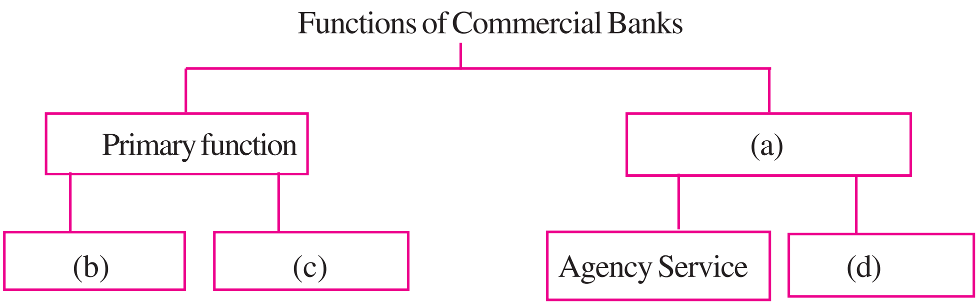
Agency Services



General Utility Services



3. Complete the flow chart



4. Choose the best alternate answer out of given four alternatives in the following questions :

   i. Overdraft facility is allowed to which type of account holder

      a) Saving Account b) Current Account

      c) Recurring Account d) Fixed Deposit Account

   ii. Anil transferred funds electronically from his account in SBI, Delhi to Deepak who has account in Punjab National Bank, Bangalore. Which type of banking service was used by Anil.

      a) Pay order b) Bank overdraft

      c) National Electronic Fund Transfer d) Issue of bank draft

   iii. Sandeep inserts his ATM card in Machine and by using his PIN, he received his transaction statement. Which type of banking service Sandeep used?

      a) Traditional banking b) E-banking

      c) Both (a) and (b) d) None of the above

   iv. Which deposit account requires deposit of money at regular periodical intervals

      a) Savings deposit account b) Recurring deposit account

      c) Current deposit account d) None of the above

2.3 INSURANCE

You know that every business faces a variety of risks. For example, there may be injury to employees in job related accidents, goods may be lost in transit; there may be

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fire in the godown, and so on. In all these situations the entire loss is to be borne by the businessman or the owner. But, now-a-days, the risk of loss or damage is not entirely borne by the owner. The insurance provides protection against losses form such risk of the business for a nominal charge called premium. In other words, it helps the business in recovering losses which may arise due to various happening in the course of business, partly or fully from the insurance company. Before discussing in detail about insurance, let us first have a brief idea about the 'business risks', their nature and insurability.

Risk is the possibility of loss or damage due to factors over which we have little or no control. Similarly business risk refers to the possibility of loss or damage on the happening of certain events which are beyond one's control. For example, while goods are transported from one place to another, there may be an accident causing damage or loss of goods. Similarly, there is a possibility that the trains may be derailed, bridge may collapse, aeroplane may crash due to an engine trouble, truck may be looted on its way to another city, or damage may be caused to goods sent by ship at the time of loading or unloading at sea ports. Again, a business may suffer loss or its profit may fall due to reduction in demand of its product because of change in the taste and fashion of the customers. The innovations of science and technology also bring about changes in the demand of a particular product in the market as happened in the case of demand for fixed line telephone which has declined due to the advent of mobile phones. The change in government policy, tax rates, interest rate etc. may also affect the earnings of a business. These are also the types of risks a business might face during its life-time.

Now the question arises as to whether all these risks are covered by insurance. The answer is 'no'. All types of business risks are not covered by insurance. Some of the risks discussed above are insurable while others are non-insurable. To be specific, the risk of loss due to fire, theft, earthquake, flood, etc. can be insured on payment of a nominal amount. These are called insurable risks. But, risk of loss on account of decline in demand of a product due to change in fashions, introduction of new products in the market or change of policy of the government cannot be insured. These are called non-insurable risks. The non-insurable risks are to be fully borne by the businessman.

2.3.1 Meaning of Insurance

The term 'Insurance' refers to a contract between two parties, one known as insured and the other insurer, whereby the insurer in exchange of a fixed amount of money agrees to compensate the insured against risks of loss or damage caused by happening of certain events. The document containing the contract is known as 'Insurance Policy'. The person whose risk is insured is called 'Insured' or 'Assured' and the person or the company which insures is known as 'Insurer',or 'Assurer'. The consideration in return for which the insurer agrees to compensate the insured is known as 'Premium'.

Thus, insurance can be defined as 'a contract between the insurer and insured whereby the insurer undertakes to pay the insured a fixed amount, in exchange for a fixed sum of money (premium), on the happening of a certain event (like attaining a certain age or on death), or pay the amount of actual loss when it takes place due to the risk insured.

2.3.2 Importance of Insurance

(a) **Protection Against Risk :** Insurance provides protection against various risks involved in business. The protection is in the form of a provision to compensate for the loss suffered by the insured.

(b) **Pooling of Risk :** Insurance helps in sharing of risk. In practice, a large number of people seek insurance by paying the premium which results in the formation of insurance fund. This fund is used for compensating a few among them who may suffer a loss. Thus, in effect the loss is spread over a large number of people.

(c) **Helps in Securing Loans :** Banks and financial institutions usually insist on the insurance of goods and properties before loans can be sanctioned on their security. So insurance makes it convenient to secure loans and advances from the financial institutions.

(d) **Protection Against Liabilities under various Labour Laws :** Insurance gives protection to businessmen in the event of compensation payable to employees for accidents leading to fatal injury, partial injury, disablement, as well as sickness and maternity.

(e) **Contribute to Economic Development :** Funds with the insurance companies are invested in various types of securities and projects, which contribute to economic development of the country.

(f) **Generation of Employment :** Insurance companies provide employment to a large number of people on regular basis. A number of people earn their livelihood working as insurance agents.

(g) **Social Security :** Life insurance provides security against risks of old age and premature death of people. Besides, social security is provided to workers through the Employees State Insurance scheme whereby accidental risks are covered.

2.3.3 Types of Insurance

Based on the subject matter of insurance or the nature of risk covered insurance can be broadly classified as under:

(a) Life Insurance

(b) Fire Insurance

(c) Marine Insurance

(d) Other types of Insurance

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Let us discuss in brief about all these types of insurance.

(a) Life Insurance

As a human being we are exposed to different types of risk. A person may face an untimely death on account of an accident or some illness. In such a situation, the family of the deceased faces financial hardship. Similarly, on attaining old age one may not have enough money to manage a comfortable living. There is still another situation when one may need a large sum of money such as marriage of a son or daughter, higher professional education, etc. Life insurance is a contract that protects you against such types of situation. It is a contract whereby the insurer undertakes to pay a certain sum of money either on the death of the insured or on the expiry of a specified period of time in consideration of a certain amount (premium) paid by the insured either in lump sum or in installments. Since the risk insured is certain to happen and the sum assured is bound to be paid sooner or later, the contract of life insurance is also referred to as life assurance.

Life insurance policy was introduced as a protection against the uncertainty of life. But gradually its scope has been extended to other areas like health insurance, disability insurance, pension plan, etc. There are two basic types of life insurance policies (a) Whole-life policy, and (b) Endowment Policy. In case of whole life policy the premium is payable regularly throughout the life of the insured or for a fixed period. The sum assured becomes payable to the heirs of the insured after his death. Such a policy is taken up by a person who wishes to provide financial support to his/her dependents after the death. An endowment policy, on the other hand, runs for a limited period or upto a certain age of the insured, and the sum assured becomes due for payment at the end of the specified period or on the death of the insured if it occurs earlier. This is the most common form of life insurance policy taken up by the people.

In addition to the types of policies discussed above, the insurance companies offer many other types of policies to attract the customers. Let us have a brief idea about some of these policies.

(i) **Joint Life Policy:** Under this policy, the lives of two or more persons are insured jointly. The sum assured becomes payable on the death of any one, to the survivor. Usually, this policy is taken up by husband and wife jointly or by two partners of the firm.

(ii) **Money Back Policy:** This scheme provides periodic payment to the policyholder unlike ordinary endowment insurance plans where the survival benefits are payable only at the maturity of the policy. For example, in case of a 20-year Money-Back policy, 20% of the sum assured becomes payable each after 5, 10, 15 years, and the balance 40% plus the bonus become payable at the 20th year.

(iii) Pension Plan: Under this plan the sum assured is payable to the policyholder on his survival beyond the term of the policy. The sum assured or policy money becomes payable in monthly, quarterly, half yearly or annual installments. This is useful for those who prefer regular income after a certain age.

(iv) Unit Plans: These plans offer twin benefits of investment and insurance cover. The premium paid by the policyholder is applied to purchase the shares and debentures of different companies. The maturity amount is largely depend upon the market value of the investment.

(v) Group Insurance Scheme: Group Insurance schemes are meant to provide life insurance protection to the group of people at a low cost. These schemes are suitable for group of employees of any business house or any office.

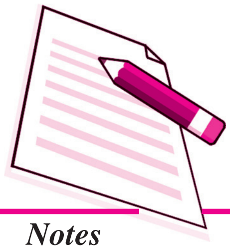
(b) Fire Insurance

Fire insurance is a contract whereby the insurer, in consideration of premium, undertakes to compensate the insured for the loss or damage suffered due to fire. The premium is payable in single installment. The fire insurance contracts are generally taken up for one year. It automatically comes to an end after the expiry of one year. However, one can renew the policy every year by paying the premium on time.

The claim for loss by fire is payable subject to two conditions, viz; (a) there must have been actual fire; and (b) fire must have been accidental, not intentional; the cause of fire being immaterial. The fire insurance contract is a contract of indemnity, that is, the insured cannot claim anything more than the value of property lost or damaged by fire or the amount of policy, whichever is lower. It may be noted that loss or damage by fire also includes the loss/damage caused by efforts to extinguish the fire with a view to minimise the loss.

(c) Marine Insurance

Marine insurance is an agreement by which the insurance company agrees to indemnify the owner of a ship or cargo against risks which are incidental to marine adventures. During an ocean journey, a ship is exposed to a variety of risks such as collision with other ship, collision of ship with hidden rocks, fire, storm, and so on. In all these situations, the entire loss is grouped into three categories: (i) loss to the ship; (ii) loss to the cargo; and (iii) loss of freight. Marine insurance that covers the risk of loss of cargo is known as Cargo Insurance. And when the owner of a ship is insured against loss on account of perils of the sea, it is known as Ship or Hull insurance. Further, the freight is usually payable by the owner of cargo on its safe delivery at the port of destination. So, the shipping company may also seek insurance of the risk of loss of freight. Such a marine insurance is known as freight insurance.



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(d) Other types of Insurance

Apart from life, fire and marine insurance, general insurance companies insure a variety of other risks through various policies. Some of these risks and the different policies are outlined below.

i) **Motor Vehicles Insurance:** Insurance of passenger cars, vans, commercial vehicles, motor cycles, scooters, etc., covers the risks of damage of the vehicle by accident, loss by theft, and so also the liability arising out of injury to, or death of a third party involved in the accident. Infact, vehicle insurance in respect of third party is compulsory.

ii) **Health Insurance:** It provides protection against the medical expenses incurred on treatment of illness or injury suffered by the policyholder. It is also termed as medi-claim insurance, and is one of the most popular type of insurance now-a-days.

iii) **Crop Insurance:** It protects the farmers from the loss suffered due to crop failure in the event of drought or flood.

iv) **Cash Insurance:** It protects the banks and other business establishment against loss of money in transit.

v) **Cattle Insurance:** It covers the risk of loss due to the death of a cow, buffalo, heifer, bull, etc. caused by accident, diseases etc.

vi) **Rajeswari Mahila Kalyan Bima Yojana:** It provides relief to the family members of the insured women in case of her death or disablement.

vii) **Amartya Siksha Yojana Insurance Policy:** This policy is meant for the education of dependant children. In case the insured parents sustain any bodily injury which causes death or permanent disablement, the insurer shall provide for education of the dependent children of the insured.

viii) **Burglary Insurance:** Under this insurance, the insurance company undertakes to indemnify the insured against losses from burglary i.e., loss of moveable goods by robbery, theft etc.

ix) **Fidelity Guarantee Insurance:** As a protection against the risk of loss caused by embezzlement or defalcation of cash or misappropriation of goods by employees, the businessmen may seek insurance covering the risks of loss on account of fraud and dishonesty on the part of the employees handling cash or in charge of stores. This is called fidelity guarantee insurance.

Notes

INTEXT QUESTIONS 2.3

1. Mention the different categories of marine insurance.
2. Identify the insurance policies in the following cases.
   a) Policy taken up by husband and wife jointly.
   b) Periodic payment to the policyholder before the maturity of the policy.
   c) Protection from loss due to crop failure.
   d) Policy that takes care of the expenditure on education of the dependent children of the policyholder.
   e) Protection against misappropriation of goods by employees.

2.3.4 Principles of Insurance

The validity of an insurance contract rests upon certain well established principles that apply to various types of insurance. These are briefly discussed hereunder.

(a) **Principle of Utmost Good Faith:** Insurance contracts are the contracts of mutual trust and confidence. Both parties to the contract i.e., the insurer and the insured, must disclose all relevant information relating to the subject matter of insurance. In case of life insurance, for example, the proposer must honestly disclose all information relating to his/her health, habits, personal history, family history etc. In case of any concealment about the material facts, the contract will not be valid. It is so because the risk can be evaluated only on the basis of these facts relating to subject matter of insurance.

(b) **Principle of Insurable Interest:** According to this principle, the insured must have insurable interest in the subject matter of the insurance. Insurable interest means financial or pecuniary interest in the subject matter of insurance. A person has insurable interest in the property or life insured if he stands to gain from its existence or loose from its damage or destruction. For example, a man has insurable interest in his own life and that of his wife, and similarly the wife has insurable interest in her husband's life. As for the property, normally it is the owner who has insurable interest in his/her property. But, when he/she (the owner) has taken loan from a housing finance company to build his/her house, the housing finance company also has insurable interest in the house and it can seek its insurance. It may be noted that in case of life insurance, the insurable interest must be present at the time of taking the policy, in case of marine insurance insurable interest must exist at the time of loss or damage to the property, and in case of fire insurance, it must exist both at the time of taking the policy as well as at the time of loss or damage to the property.

(c) **Principle of Indemnity:** The word indemnity means compensating somebody for the actual loss suffered by him; or restore someone to the same position that he/she was in before the insured event took place. This principle is applicable to the fire and marine and general insurance. It is not applicable to life insurance because the loss of life cannot be restored.

The principle of indemnity implies that the insured is not allowed to make any profit from the insurance contract on the happening of the event that is insured against. Compensation is paid on the basis of amount of actual loss or the sum insured, which ever is less. Let us understand with the help of an example. A person insures his house against fire for Rs. 20 lakh. The fire takes place and he has to spend Rs. 5 lakh to repair the damage so caused. He can claim only Rs. 5 lakh from insurer and not the sum assured.

(d) **Principle of Contribution:** The same subject matter may be insured with more than one insurer. In such a case, the insurance claim to be paid to the insured must be shared or contributed by all insurers in proportion to the amount of sum assured by each one of them. If one insurer has paid the full compensation to the insured, he has the right to ask other insurers to share the loss proportionately. It may be noted that in case of multiple insurance, the insured can claim the loss from any of the insurers subject to the condition that the insured can not recover more than the amount of actual loss from all taken together.

(e) **Principle of Subrogation:** According to this principle, once the claim of the insured has been settled, the ownership right of the subject matter of insurance passes on to the insurer. In other words, if the damaged property has any value, such property can not the allowed to remain with the insured because otherwise the insured will realise more than the actual loss which goes against the principle of indemnity. Hence, when goods worth Rs. 1,00,000 are damaged due to accident and the insurance company pays the full compensation to the insured, the insurance company takes the possession of that damaged property and is entitled to dispose off that property.

(f) **Principle of Mitigation:** In case of a mishap the insured must take all possible steps to reduce or mitigate the loss or damage to the subject matter of insurance. This principle ensures that the insured does not become negligent about the safety of the subject matter after taking an insurance policy. The insured is expected to act in a manner as if the subject matter has not been insured. If appropriate steps are not taken to save the assets, then the insured may not get the full compensation from the insurance company. For example, if a house is insured against fire and the fire takes place, the owner must take all possible steps to extinguish the fire and minimise the loss. Similarly, when a house is insured against theft, he must take all precautions and steps to prevent theft.

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(g) **Principle of *Causa-proxima* (nearest cause):** According to this principle, the insured can claim compensation only if the loss is caused by the event insured against. In other words, unless the event insured is nearest cause (not a remote cause) for the loss occurred, the insured can not claim the loss from the insurance company. For example a ship carrying orange was insured against losses arising from accident. The ship reached the port safely and there was a delay in unloading the oranges from the ship. As a result, the oranges got spoilt. The insurer did not pay any compensation for the loss because the proximate cause of loss was delay in unloading and not an accident during the voyage.

INTEXT QUESTIONS 2.4

1. What is meant by 'Insurable interest'?
2. Name the principle of insurance violated in the following cases.
   (a) 'A' does not own the building but is trying to get it insured as a party to the insurance policy.
   (b) 'A' enters into life insurance contract with LIC of India. 'A' was ailing with heart decease but he did not reveal this at the time of entering the contract.
   (c) 'B' enters into insurance contract with two companies 'C' and 'D'. The subject matter is a building worth Rs. 5 lakh. The building caught fire and properties worth Rs. 3 lakhs were damaged. 'C' paid the entire claim and asked 'D' to share the claim. 'D' denies.
   (d) Goods worth Rs. 50,000 are damaged and the insurance company pays the claim to 'Z' for the loss. 'Z' not only took the compensation for loss but also claims the damaged goods.
   (e) 'P' takes an insurance policy for Rs. 1 lakh with 'Q' company. The goods of 'P' are damaged due to fire the loss incurred is Rs. 25,000. 'Q' shall restore the actual loss but 'P' claims full amount of the policy.

2.4 TRANSPORTATION

You are fully aware that the goods produced at one place may be used or consumed at various places as the markets for goods now-a-days are spread over length and breadth of the country and even extend to countries across the border. Hence the goods have to be carried from place of production to the place of consumption or use. The process of carrying goods and passengers from one place to another is termed as 'transportation' and the mode used there for are roadways, railways, airways and/or water ways. In fact, transportation facilitates trading activities to create place utility to goods by removing the barriers of distance (hindrance of place) between production and consumption.

Notes

2.4.1 Importance of Transportation

(a) Transport plays a very important role in distribution of goods both within a country and across the borders.

(b) Transport helps in bringing about stable and uniform prices in different markets as traders are able to adjust the supply of goods at different places according to the changing demand.

(c) Consumers have the benefit of getting goods at their door step and have a wider choice of goods at competitive prices.

(d) It ensures continuous supply of raw materials to the industry.

(e) It contributes to growth of large scale industries by facilitating the inflow of materials and outflow of finished goods.

(f) International competition is encouraged with the improved transport system. This makes global markets accessible to sellers and buyers of different countries.

2.4.2 Modes of Transport

While travelling from one place to another we use a car, a bus or a train. People also use boat, ship, aircraft for their movement. These are all various means through which we move from place to place. All these means of transport need the support of a particular medium or mode through which it will travel. For example, a truck needs the support of road, an aeroplane needs the support of air and a ship needs water to travel. So the modes of transport can be classified as (a) road transport, (b) rail transport, (c) water transport, and (d) air transport. Let us have a brief idea about these modes of transport.

(a) Road Transport : Transport by road is undertaken through animals (horses, camels, donkeys), vehicles drawn by animals (bullock-carts), and by Motor Vehicles (Vans, trucks, etc.). Use of animals and vehicles drawn by animals have limited use only in rural areas. Vans are limited to local transports within the city. Most goods traffic moves through trucks which are considered convenient, economical and safe.

(b) Rail Transport : Rail transport refers to movement of passengers and goods by trains which are on railway tracks laid for the purpose. In terms of carrying capacity over long distances rails transport is economical and safe. In India, railways are owned by government of India and most commonly used mode of goods transport

(c) Water Transport : Water transport refers to movement of goods and passengers on waterways by using various means like boats, steamers, launches, ships, etc. This movement may takes place inside the country or from one country to another.

Movement of goods through inland waterways in India is highly limited because of unavailability of inland water ways and limited facilities. Transportation by sea and ocean is quite common in coastal areas and for international trade. It is relatively more economical for bulky goods to be carried over long distance.

(d) **Air Transport :** Movement of goods and passengers by using aircrafts is termed as air transport. It is the speediest mode of transport and is mostly used for carrying passengers. As for goods, air transport is mostly used for goods of high value and low volume such as medicines, spare parts for machinery, electronic components etc. With the provision of large cargo planes, the use of air transport for goods has considerably increased within the country and for international trade.

INTEXT QUESTIONS 2.5

1. Define the term 'transportation'.
2. Suggest suitable mode of transportation in the following cases.
   (a) Transport of perishable goods within the country.
   (b) Transport of goods of high value and low volume.
   (c) Quickest mode for carrying passengers.
   (d) Convenient mode for short distance travel.
   (e) Economical mode of transport for long distance within the country.

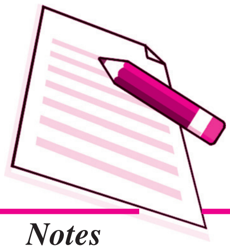
2.5 COMMUNICATION

Communication is the process of transmission of ideas, opinions, thoughts and information through speech, writing, gestures or symbols between two or more persons. Communication always contains a message which is transmitted between the parties. There are minimum of two parties involved in communication - one is 'Sender', and the other is 'Receiver'. The process of communication is said to be complete when the receiver receives the message and responds to it or acts according to it.

2.5.1 Types of Communication

Based on the method used, communication may be oral, written or non-verbal. These are explained in brief hereunder.

(a) **Oral Communication :** When a message is transmitted orally i.e., through spoken words it is called oral communication. It may be in the form of lectures, meetings, group discussions, conferences, telephonic conversations, radio message and so on. It is considered to be quite an effective and economical method of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communication (both in term of money and time), and is most commonly used for internal as well as external communication. The major drawback with verbal communication is that it cannot be verified as normally it is not put on record.

(b) **Written Communication :** When a message is transmitted through written words (in writing in the form of letters, telegram, memos, circulars, notices, reports etc. it is called written communication. It provides a record of the message and feedback which is available for verification as and when required. Normally, one is very careful to the point and precise while sending a written communication. However, it is formal, lacks personal touch and difficult to maintain secrecy.

(c) **Non-verbal Communication :** Communication without any use of words is called non-verbal communication. Sometimes when you look at some pictures, graphs, symbols, diagrams etc. some message is conveyed to you. All these are different forms of visual communication. Bells, whistles, buzzers, horns etc. are also the instruments through which we can communicate our message. Communication with the help of these types of sounds is called 'aural' communication. Similarly, communication is also made through some physical gestures through the use of various parts of the human body through body language. This is termed as 'gestural' communication. Saluting our national flag, motionless position during the singing of national anthem, waving of hands, nodding of head, showing anger on face, etc. are all examples of gestural communication. When a teacher pats his student on his back, it is considered as an appreciation of his work and it encourages the student to do still better.

2.5.2 Communication Services

For sending the message or getting the response, you require a medium. Such medium is termed as 'means of communication'. It carries the message to the receiver and a feedback or response from him. The commonly used means of communication are: postal mail services, courier services, telephone, cellular phone, telegraph, internet, fax, e-mail, voice mail. These means are also termed as 'communication services'. Of these, the main services which help business in its effective communication, are classified as (1) Postal Services, and (2) Telecommunication Services.

2.5.3 Postal Services

The postal system in India was established in 1766 by Lord Clive for sending official mails. It was made available to the public in 1837. The Indian postal service has the largest network of 1,55,516 post offices throughout the country, out of 1,39,120 are in rural areas. These are mainly concerned with collection, sorting, and distribution of letters, parcels, packets, etc. Besides, a number of other services are also provided to the general public as well as business enterprises. Let us classify the various postal services as:

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(a) **Mail Services :** The postal mail service deals with both inland and international mails. An inland mail is one where the sender and receiver of the mail reside within the same country. On the other hand, where the sender and receiver of the mail reside in different countries it is called an international mail.

While sending a written message, the sender can make use of a post card, an inland letter, or an envelope. For sending some item in a packet, parcel post facility is provided. Articles in the form of printed materials, printed books, periodicals, greeting cards can also be mailed by book post.

Besides these general mail services, some specialised mail services are also provided by the post office for convenience of the public. Let us know these services in brief.

(i) **Certificate of Posting :** For ordinary letters, the post office does not give any receipt. But, if the sender wants a proof that he or she has actually posted the letter, then a certificate can be obtained from the post office on payment of prescribed fee which is called 'certificate of posting'. These letters are marked as 'Under Postal Certificate' (UPC).

(ii) **Registered Post :** If the sender wants that the mail should definitely be delivered to the addressee otherwise it must return to him, then post office offers 'registered post' facility. For this service, the post office charges additional amount and issues a receipt for the registered post.

(iii) **Insured Post :** To compensate for the loss incase the letters or parcels get damaged or lost in transit, the post office provides insured post facility. For this the post office acts as an insurer. The insurance premium is paid by the sender.

(iv) **Speed Post :** This facility provides quick, time bound as well as guaranteed mail delivery in some selected destinations on payment of additional charge. This facility is available in more than 1000 post offices in India and links with 97 countries.

(v) **Post Restante :** When the exact postal address of the receiver is not known, the sender can avail of post restante facility. The letter can be sent to the postmaster of the locality where the receiver resides. The receiver can collect the letter from the post office on showing his identity. This facility is suitable for tourists and travelling salesmen who are not sure about their address in a particular place, or for any other person looking for a fixed address at a new place.

(b) **Financial Services :** Various financial services are provided by the post office through Saving Schemes, Remittance Services, and Distribution of Mutual Funds and Securities.

(i) Saving Schemes: There are eight different schemes offered by the post offices to mobilise the savings from the public. These are:

(a) Post Office Savings Bank Account

(b) 5-Year Post Office Recurring Deposit Scheme

(c) Post Office Time Deposit Account

(d) Post Office Monthly Income Scheme

(e) 6-Year National Savings Certificates (VIII Issue) Scheme

(f) 15-Year Public Provident Fund Account (PPF Account)

(g) Kissan Vikas Patra Scheme

(h) Senior Citizens Saving Scheme 2004

(ii) Remittance Service: Money can be conveniently transferred from one place to other through the remittance service offered by the post office. It is in the form of Money Order and Postal Order facility with the help of which people can transfer money from one place to another within as well as outside the country. Money order is an order issued by one post office to another post office to pay a certain sum of money only to the person named therein. The sender hands over the money to the post office and on payment of the requisite fee, post office takes the responsibility of giving the money to the receiver. In a single money order form, we can send a maximum amount of Rs. 5,000. For the convenience of customers, post office offers different types of money order services like Ordinary Money Order, Telegraphic Money Order, Satellite Money Order, Speed-post Money Order, Instant Money Order (INO), International Money Transfer Services, etc. For the convenience of businessmen it also offers Corporate Money Order service.

Like Money Order, we can also send money through postal order i.e., Indian Postal Order (IPO). It is a convenient method of sending money from one place to another and is mainly used for remitting examination fees or while applying for any job.

(iii) Distribution of Mutual Funds and Securities: This facility enables the investors to purchase mutual funds and government securities through the designated post offices. The mutual funds of State Bank of India, prudential ICICI, RBI/Govt. Relief Bonds and ICICI Safety Bonds are available from 42 post offices at Bangalore, Chennai, Chandigarh, Delhi and Mumbai.

(c) Insurance Services : In addition to dealing with mail and remittance of money, post offices also provide life insurance coverage to individuals. There are two

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different schemes of insurance offered by post office. These are (i) Postal Life Insurance (PLI), and (ii) Rural Postal Life Insurance (RPLI). The Postal Life Insurance was introduced in 1884 as a welfare measures for the employees of Posts and Telegraphs Department. Later on it was extended to the employees of Central and State governments, public sector undertakings, universities, government aided institutions, nationalised banks and financial institutions, local bodies like Municipalities and Zilla Parisads. The employees of these organisations who are below 50 years of age, can insure their life on payment of a fixed premium for a particular period. The PLI offers five insurance schemes viz. (i) Suraksha (whole life insurance) (ii) Suvidha (Convertible whole life assurance), (iii) Santosh (endowment assurances) (iv) Sumangal (Anticipated endowment assurance), (v) Yugal Suraksha (joint life endowment assurance for couples). Just like PLI, the post office also provides life insurance coverage to the people living in rural areas at low premiums under the scheme of Rural Postal Life Insurance (RPLI). This was introduced on 24 March 1995. All the above mentioned plans are available under RPLI also.

(d) **Business Development Services :** Besides carrying mail through various means as discussed earlier, post office offers some special services to the business firms. Let us learn in brief about those services.

(i) **Business Post:** In this service, post office undertakes all the pre-mailing activities of the bulk senders. Pre-mailing activities include collection from sender's doorstep, insertion of goods in packet, pasting and addressing as well as franking of mails, etc.

(ii) **Media Post:** The postal department offers a unique media to help the corporate and government organisations to reach the potential customers through media post. Under this facility, (a) advertisements are allowed on post cards, inland letter cards and in other postal stationeries, and (b) space sponsorship options on letter boxes.

(iii) **Express Parcel Post :** Post office offers a reliable, speedy and economical parcel service to the corporate and business customers through its express post. It provides a time bound door-to-door delivery of parcels upto 35 kgs. in weight and VPP services upto Rs. 50,000.

(iv) **Direct Post :** It allows the business houses to send the pamphlets, brochures and other advertising materials like CDs, floppies, cassettes, samples, etc. to the prospective customers at very low rates.

(v) **Retail Post :** The post office offers the facility to collect public utility bills like telephone, electricity, and water bills, sale of application forms for government and other private organisations, survey through postmen, address

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verification through postmen are some of the activities undertaken under retail post.

(vi) **Business Reply Post :** Under this facility post offices allow the customers to send their reply through business reply post, which does not require any postage from the sender. The post office recovers the postage from the addressee later on.

(vii) **Post Shoppe :** Post shoppes are the small retail shops established for sale of postal stationery items, greeting cards and small gift items to the customers. These shops are found within the premises of some post offices.

(viii) **Value Payable Post (VPP) :** This facility is offered to meet the requirement of the traders who wish to sell their articles and collect the price of articles supplied by them through the post offices. Under this service, post office receives the properly packed goods from the seller and carries those to the customers. After receiving the total amount (the price of the goods plus the VPP charges) from the customer, it delivers the goods to him/her. Later on, the post office sends the amount due to the seller.

(ix) **Corporate Money Order :** Like individuals, business organisations can also transfer money through money order. For them, the post office offers Corporate Money Order Service. It enables business organisation to transfer upto Rs. 1 crore to any part of the country.

(x) **Post-box and Post-bag Facility :** Under this facility, a particular number and a box or a bag is allotted to the receiver at the post office to receive all unregistered mails. Post office keeps all mails addressed to that number in those boxes or bags. The addressee makes necessary arrangement to collect the mails as per his convenience. This facility is mostly suitable for business firms which want to receive their mail promptly. Those who do not have any fixed address or those who do not want to disclose their names and address can avail of this facility on payment of the specified rent.

(xi) **Bill Mail Service :** It provides cost effective solution for mailing of periodic communication with nature of annual report, bills, monthly account bills or other items of similar nature.

(xii) **E-post :** E-post service launched on 30^{th} January, 2004 this has enabled people to send and receive messages through e-mail in all post offices of the country. To make it more useful for business, a corporate version of e-mail was also launched on 18^{th} October 2005, which allows simultaneous sending of e-post to a maximum of 9999 addresses.

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INTEXT QUESTIONS 2.6

1. Give one word substitute of the following communication.
   (a) Conversation with the help of telephone.
   (b) Communication through symbols and diagram.
   (c) Traffic signal showing red light.
   (d) Sending SMS to friends through mobile phone.
   (e) Saluting our nation flag in different occasion.
2. Match the following

Column A	Column B
(a) Retail post	(i) Collection of letters from the customers' doorstep
(b) Media post	(ii) Compensation for loss or damage of the parcels
(c) Direct post	(iii) advertisement on post card
(d) Business post	(iv) Collection of telephone bill
(e) Insured post	(v) Sending pamphlets to prospective customers.

2.5.4 Telecommunication Services

The first telegraph line between Kolkata and Diamond Harbour was opened for traffic in 1851. The first telephone service was introduced (in Kolkata) in 1881-82, and the first automatic exchange was commissioned at Shimla in 1913-14. As of now, India is the 10th largest telecom network in the world in terms of number of phones. The various telecommunication services now available in India are as follows.

(a) **Fixed Line Phone :** The fixed line phone or telephone is a very popular means of verbal communication. It is widely used for internal and external business communications. It facilitates both oral conversation as well as sending written text messages. Both government and private telecom companies provide this service in our country.

(b) **Cellular Services :** Now-a-days, cellular phones or mobile phones are very popular as they give access to the receiver at all times and everywhere. This is an improvement over the fixed line telephone. It possesses many modern features like Short Messaging Services (SMS), Multi Media Messaging Services (MMS) etc. MTNL. BSNL, Airtel, Idea, Hutch, Reliance and Tata are the leading mobile phone service providers in our country.

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(c) **Telegram :** It is a form of written communication by which messages can be sent quickly to distant places. It is generally used when there is an urgency of communicating an important message. **Now a days this facility is not available in any of the telegraph offices.**

(d) **Telex :** Telex provides a means of printed communication using teleprinter. The teleprinter is a tele-typewriter having a standard keyboard and connected through telephone.

(e) **Fax :** Fax or facsimile is an electronic device that enables instant transmission of handwritten or printed matters to distant places. By using telephone lines, this machine sends the exact copy of the document to another fax machine at the receiving end. This is the most commonly used means of written communication in business now-a-days.

(f) **Voice Mail :** It is a computer based system for receiving and responding to incoming telephone calls. It records and stores telephone messages through computer memory. The caller can get the required information by dialing the voice mail number and then following the instructions of the computer. The individuals can also record their messages through voice mail. The receivers at their own convenience can get the message from the machines and take action accordingly.

(g) **E-mail :** Electronic mail, popularly known as e-mail is a modern means of communication that transmits the written message, pictures or sounds etc. from one computer to the others connected through internet facility.

(h) **Unified Message Service :** It is a system by which fax, voice mails and e-mails (all three) can be received from one mail box using telephone instrument, fax machine, mobile phones, internet browsers, etc.

(i) **Teleconferencing :** Teleconferencing is a system through which people can interact without physically sitting in front of each other. People can hear the voice and see the picture of others and also respond to their queries while sitting in different countries. It makes the use of modern electronic devices like telephone, computers, television etc.

2.5.5 Importance of Communication

(a) **Promotion of Business :** Because of modern means of communication, businessmen sitting at different places can finalise their business deals without much difficulty. They can make enquiries, settle terms and conditions, place orders and send confirmation. It has helped in the growth of national as well as international trade.

(b) **Mobility of Labour :** People who have gone for employment to places away from their homes and families are able to keep in touch with their friends and relatives through the various means of communication. So they willingly go to far off places for employment.

(c) **Socialisation :** Through communication facilities like telephone, fax and e-mail etc. people are able to exchange messages, information etc. with their friends and relatives on a regular basis. This helps in maintaining and developing social relations among people.

(d) **Coordination and Control :** Offices of big business houses and government departments may be situated at different places. There may be many departments in the same building. Effective communication between them helps in coordinating their activities and exercising control over them.

(e) **Efficiency in Job Performance :** Effective communication contributes a great deal to higher in job performance as regular communication within a business unit ensures a willing cooperation of others due to the close understanding of ideas and instructions.

(f) **Helpful to Professionals :** Lawyers are to attend courts situated at different places, doctors are to visit different nursing homes, chartered accountants have to go to different offices of companies. Mobile phones help these professionals in changing and adjusting their schedule as required without any difficulty.

(g) **Meeting Emergencies :** In the event of accidents or incidents of fire, immediate help can be asked for and made available through modern means of communication.

(h) **Sea and Air Navigation :** Means of communication are extremely important for the navigation of ships and aircrafts which need to be guided from control rooms at particular locations.

(i) **Spread of Education :** Broadcasting of educational programmes on radio and telecasting on televisions are popular means of educating students without the necessity of personal coaching.

(j) **Advertisement :** Radio and television as means of mass communication have increasingly become important as media of advertisement for business firms as it is possible to reach the masses by such means.

INTEXT QUESTIONS 2.7

1. Mention any two problems we may face in the absence of telecommunication services.

2. Complete the following incomplete words by taking clues from the statement given for each. Every blank represents one letter only. First one has been done for you.

   (a) T __ L __ X (TELEX)

   (b) V __ __ C __ MAIL

(c) __ __ X

(d) T __ L __ __ R __ M

(e) E __ M __ __ __

Clues

(a) Communication using tele-printer

(b) Computer based system for receiving and responding the incoming telephone calls.

(c) Machine that transmits hand written massage instantly.

(d) A form of written communication.

(e) Communication of written message through internet.

2.6 WAREHOUSING

The words ‘warehouse’ and ‘godown’ are synonymous and so warehouse refers to a place used for storing goods, and warehousing refers to the activities involving storage of goods on a large-scale in a systematic and orderly manner and making them available conveniently when needed. In other words, warehousing means holding or preserving goods in huge quantities from the time of their purchase or production till their actual use or sale. Thus, it creates time utility by bridging the time gap between production and consumption of goods.

2.6.1 Importance of Warehousing

As stated earlier, warehousing bridges the time gap between production of goods and their consumption, and thus, serves useful purpose particularly for large-scale business operations. Based on its uses, its importance can be briefly described as follows.

(a) Storage of Raw Materials : To maintain continuity in production, a good quantity of raw materials is to be kept in stock. Not only that, some raw materials are only available in specific period of the year (cotton, oilseeds etc.) while these are used for production throughout the year. So, these have to be kept in stock for use as and when required.

(b) Storage in Anticipation of Rise in Price : In case the manufacturer anticipates a rise in prices of raw materials in future he/she likes to purchase it in advance and stock it. It equally applies to traders of goods if they expect price rise.

(c) Storage of Finished Goods : Since goods are generally produced in anticipation of demand, these need to be stored till sales take place. Not only that, some goods are produced round the year but purchased/used during a specified part of the year e.g. electric fans, woollen clothes. Similarly, some goods may be produced during a part of the year but used throughout the year like sugar.

(d) **Storage of Goods by the Wholesalers :** Wholesalers buy goods in bulk and maintain stock of goods in warehouses for sale in small quantities to retailers from time to time.

(e) **Packaging and Grading :** Goods in warehouses are divided into grades according to size or quality and packaging is done for convenient handling and sales.

(f) **Use for Importers :** Warehouses (known as bonded warehouse) are used for storage of imported goods till the importer is able to pay the customs duty and take delivery.

Based on the above uses of warehousing, it can be concluded that it is an important link in the chain of marketing and adds to the time and place value of goods. It also smoothens out fluctuations in their supply and demand. So, wherever there is trade and commerce, there is need for warehousing.

2.6.2 Types of Warehouses

You have learnt that warehousing caters to the storage needs of various types of commodities. In order to meet their storage requirement effectively, various types of warehouses came into existence. These are as follows.

(a) **Private Warehouses :** The warehouses which are owned and operated by the manufacturers or traders to store exclusively their own stock of goods, are known as private warehouses.

(b) **Public Warehouses :** The public warehouse is an independent unit which stores goods of other firms. Any one can store his goods in these warehouses on payment of rent.

(c) **Government Warehouses :** These warehouses are owned, managed and controlled by the government. Central Warehousing Corporation of India, State Warehousing Corporation and Food Corporation of India are examples of government warehouses. Both government and private enterprises may use these warehouses to store their goods.

(d) **Bonded Warehouses :** Bonded warehouses to store imported goods for which import duty is yet to be paid. These warehouses are generally owned by dock authorities and found near the ports.

(e) **Co-operative Warehouses :** These warehouses are set up by the cooperative societies for the benefits of their members. They provide warehousing facilities at the most economical rates.

2.6.3 Functions of Warehouses

The warehouses preserve goods on a large-scale in a systematic and orderly manner. They provide protection to goods against heat, wind, storm, moisture, etc. and also minimize losses due to spoilage, wastage etc. In addition to this, warehouses now a days also perform a variety of other functions as stated below:

(a) **Storage of Goods :** The basic functions of warehouses is to store goods properly till they are required for use, consumption or sale.

(b) **Protection of Goods :** A warehouse provides protection to goods from loss or damage due to heat, dust, wind and moisture, etc. It makes special arrangements for different products according to their nature.

(c) **Risk Bearing :** The risk of loss or damage to goods in storage is borne by the warehouse keeper. So, he takes all precautions to ensure their safety.

(d) **Financing :** When goods are deposited in any warehouse, the depositor gets a receipt which acts as a proof of the goods in store. This receipt can be used as a security to obtain loans and advances from the banks and other financial institutions. Some warehouse keepers themselves advance money to the depositors for a short period against the security of their goods in their warehouses.

(e) **Processing :** Certain commodities are not consumed in the form they are produced. Processing is required to make them consumable. For example, paddy is polished, timber is seasoned, and fruits are ripened, etc. Sometimes warehouses also undertake these activities on behalf of the owners.

(f) **Value Added Services :** The warehouse keeper may also undertake to perform the functions of grading and branding of goods on behalf of the manufacturer, wholesaler or the importer of goods. He may provide facilities for mixing, blending and packaging of goods for convenience in handling and sale.

(g) **Transportation :** In some cases warehouses provide transport arrangement to the bulk depositors. It collects goods from the place of production and also sends goods to the place of delivery on request of the depositors.

INTEXT QUESTIONS 2.8

1. Give the meaning of warehousing.
2. Identify the type of warehouse in the following cases.
   (a) Warehouse to store the goods of public.
   (b) Warehouses owned and managed by government.

(c) Warehouses for storage of imported goods on which import duty is yet to be paid.

(d) Warehouses set up for the benefit of its members.

(e) Warehouses owned and managed by private traders for stocking their goods.

Notes

WHAT YOU HAVE LEARNT

- Activities that act as auxiliaries to trade and facilitate smooth flow of goods from producers to consumers and functioning of business are termed as business support services.

- Banking refers to the provision of services by banks like acceptance of deposits, grant of loans and advances and other agency as well as general utilities services.

Types of Bank

- Commercial Bank
  - Public Sector Bank
  - Private Sector Bank
  - Foreign Bank
- Cooperative Bank
  - Primary Credit Society
  - Central Cooperative Bank
  - State Cooperative Bank
- Development Bank
  - IFCI
  - IDBI
  - SFC
- Specialised Bank
  - EXIM
  - SIDBI
  - NABARD
- Central Bank
  - RBI

- Functions of commercial banks

  (a) Primary functions : (i) Accepting deposit (ii) Lending money

  (b) Secondary functions : (i) Agency services (ii) General utility services

- Fixed Deposit Account, Recurring Deposit Account, Current Deposit Account and Savings deposit Account are different types of bank accounts.

- A lumpsum amount is deposited for a specified time in fixed deposit account.

- In RD accounts, the account holder is required to deposit a specified sum of money every month.

- To cultivate saving habit, savings account is opened.

- Current deposits accounts provide facility to business persons to deposit or withdraw money as and when they need.
- Bank draft is a cheque drawn by a bank branch on another branch outside the city.
- A pay order is a cheque drawn by a bank branch and payable at same branch.
- RTGS is a fund transfer system where there is no waiting period for the settlement of transaction. Minimum transaction value is Rs. 50,000.
- NEFT is a fund transfer system and transactions are settled in batches.
- Persons not holding current account are eligible for credit arrangements through cash credit facility.
- SMS alert is an e-banking facility where in the customer remains informed about every deposit/withdrawal from his account.
- Parcels and couriers are type of postal services.
- Saving services provided by post office include NSC, PPF, and MIS.
- Insurance is a contract between the insurer and insured whereby the insurer undertakes to pay a fixed amount of money to compensate the insured against risks of loss or damage caused by happening of certain events, in exchange for a fixed sum of money.
- Based on the subject matter of insurance and nature of risk covered, insurance can be broadly classified as (a) Life insurance, (b) Fire insurance, (c) Marine insurance, and (d) Other types of insurance.
- Principles of insurance : (a) Utmost good faith; (b) Insurable interest; (c) Indemnity; (d) Contribution; (e) Subrogation; (f) Mitigation; (g) Cause proxima
- Transportation: The process of carrying goods and passengers from one place to another is termed as transportation. The mode used for transportation are roadways, railways, airways and water ways.
- Communication is the process of transmission of idea, opinion, thoughts and information through speech, writing, gestures or symbols between two or more persons.
- Based on the method used, communication may be oral, written or non-verbal. Communication without any use of words is called non-verbal communication. It may be visual, aural or gestural.
- The main services which help business in its effective communication are classified as postal services and telecommunication services.

- The various services provided by post offices are classified as (a) Mail services, (b) Financial services, (c) Insurance services, and (d) Business development services.
- The various special services offered by post office to the business firms are – Business post, Media post, Express parcel post, Direct post, Retail post, Business reply post, Post shoppe, Value payable post, Corporate money order, Post Box and Post bag facility, E-post and Bill Mail service.
- The telecommunication which are helpful for business firms are fixed line phone, cellular service, telegram, telex, fax, voice mail, e-mail, teleconferencing.
- Warehousing refers to the activities involving storage of goods on a large scale in a systematic and orderly manner and making them available conveniently when needed.
- The different types of warehouses functioning in our country are – Private warehouses, Public warehouse, Government warehouse, Bonded warehouse and Cooperative warehouse.
- The functions of warehouse are – storage of goods, protection of goods, bears the risk of loss or damage to goods in storage, financing, processing, transportation. It also performs various value added services like grading and branding, mixing, blending and packaging of goods.

KEY TERMS

Banking	Fire Insurance	Post restante
Bonded warehouse	Fidelity guarantee insurance	Post shoppe
Burglary insurance	Health insurance	Postal life insurance
Business post	Indemnity	Principles of contribution
Cash insurance	Insurable interest	Principles of mitigation
Cattle insurance	Insurance	Principles of subrogation
Central Bank	Insured post	Retail post
Commercial Bank	Joint life policy	Specialised Bank
Cooperative Bank	Marine insurance	Value payable post
Crop insurance	Media post	Voice mail
Direct post	Money back policy	Warehousing
Endowment policy	Motor vehicles insurance	Whole-life policy
Express post	Pension Plan	

Notes

TERMINAL EXERCISE

Very Short Answer Type Questions

1. What is meant by the term 'Banking'?
2. Define the term 'Insurance'.
3. Name the hindrance that is removed by transportation.
4. State the benefits of insured post.
5. What is bonded warehouse?
6. Give an example of e-banking.
7. Name any two savings schemes of post office.
8. Give the full form of PPF and MIS.

Short Answer Type Questions

9. Mention any two general utility services rendered by commercial banks.
10. Distinguish between whole-life policy and endowment policy.
11. State any two points of importance of transportation for the business.
12. What is meant by post restante letter.
13. Explain any two functions of warehousing.
14. What is meant by cash credit?
15. What is meant by a Bank overdraft?
16. Give the full form of NSC.
17. What is meant by courier service?

Long Answer Type Questions

18. Explain the primary functions of a commercial bank.
19. Describe any two principles of a valid insurance contract.
20. What is meant by transportation? State any two different modes of transport.
21. Describe any four special services rendered by the post office for the benefit of business.
22. Explain any four points of importance of warehousing.
23. **"Post office provides the various services in addition to mail service." In the light of this statement explain the different services provided by the Post office.**
24. **Your friend Nitesh feels that warehousing is of no importance. Explain him about the importance of warehousing.**

ANSWERS TO INTEXT QUESTIONS

2.1 1. Business support service refer to those business activities that act as auxiliaries to trade and facilitate smooth flow of goods from producers to consumers.

2. (a) Transportation, (b) Banking, (c) Insurance, (d) Warehousing, (e) Communication

2.2 1. Central bank/Reserve Bank of India

2. Agency services - (a), (e)
General utility service – (b), (c), (d)

3. (a) Secondary functions (b) Accepting deposits
(c) Lending money (d) General utility services

4. (i) b (ii) c (iii) b (iv) b

2.3 1. (a) Cargo insurance (b) Ship or Hull insurance
(c) Freight insurance

2. (a) Joint life policy (b) Money back policy
(c) Crop Insurance (d) Amartya Siksha Yojana insurance policy
(e) Fidelity guarantee insurance

2.4 1. Insurable interest means financial or pecuniary interest on the subject matter of insurance.

2. (a) Principle of insurable interest (b) Principle of utmost good faith
(c) Principle of contribution (d) Principle of subrogation
(e) Principle of Indemnity

2.5 2. (a) Road transport (b) Air transport (c) Air transport
(d) Road transport (e) Rail transport

2.6 1. (a) Oral Communication (b) Visual Communication
(c) Visual Communication (d) Written Communication
(e) Gestural Communication

2. (a) – (iv) (b) – (iii) (c) – (v) (d) – (i) (e) – (ii)

2.7 2. (b) VOICE MAIL (c) FAX (d) TELEGRAM (e) E-MAIL

2.8 1. Activities that involve storage of goods on large scale and making them available when demanded.

2. (a) Public warehouse (b) Government warehouse
(c) Bonded warehouse (d) Cooperative warehouse
(e) Private warehouse

Notes

DO AND LEARN

Visit the nearest post office of your area and collect information on the various services provided to the public and business community. Also collect pamphlets on the various saving schemes available.

ROLE PLAY

1. Deeksha is working as an agent of life insurance and Sunita is working as an agent of General insurance. Read and complete the following Conversation:

   Deeksha : Sunita, I heard that you are a GIC agent. Could you tell me what is the subject matter of insurance.

   Sunita : Well! Unlike the life insurance our subject matter of insurance is the goods that need risk coverage in business.

   Deeksha : This is very interesting! Could you tell me more about it?

   Sunita : Yes, of course! I do not know anything about life insurance. First you advise me how should I proceed in taking a policy to protect my life?

In the light of the basic principles, different types of policies, continue the conversation between the two friends. You can take the role of one of the agents and ask one of your friends to enact the other role.

2. Raksha is working as a Bank Manager and her friend Seema is a housewife. Read and complete the following conversation:

   Raksha : Hello Seema. How are you?

   Seema : I am fine. Raksha, I heard that you are working as a Bank Manager could you tell me something about the banking?

   Raksha : Well! Bank is an institution that deels in money and credit.

   Seema : The work of Bank is very interesting. Could you tell me something more about it?

Raksha : Yes, of course! Bank accepts deposits from those who have funds to spare and grants loans and advances to those who are in need of funds for various purpose.

In the light of various functions of Bank, continue the conversation between the two friends. You can take the role of any one friend and ask one of your friends to enact the other role.

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BUSINESS ENVIRONMENT

Understanding the environment within which the business has to operate is very important for running a business unit successfully at any place. Because, the environmental factors influence almost every aspect of business, be it its nature, its location, the prices of products, the distribution system, or the personnel policies. Hence it is important to learn about the various components of the business environment, which consists of the economic aspect, the socio-cultural aspects, the political framework, the legal aspects and the technological aspects etc. In this chapter, we shall learn about the concept of business environment, its nature and significance and the various components of the environment. In addition, we shall also acquaint ourselves with the concept of social responsibility of business and business ethics.

OBJECTIVES

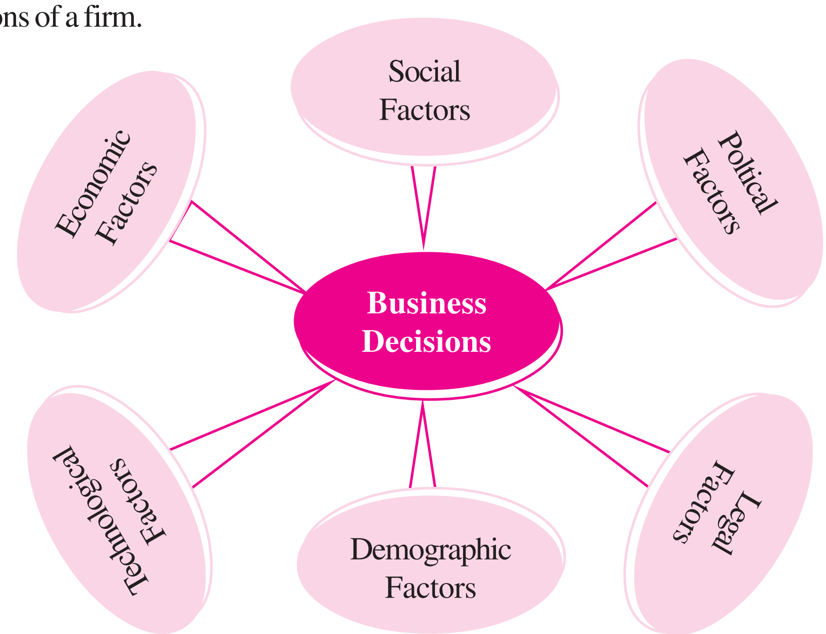
After studying this lesson, you will be able to:

- explain the meaning of business environment;
- identify the features of business environment;
- describe the importance and types of business environment;
- describe the recent developments in Indian Economy that have greatly influenced the working of business units in India;
- explain the concept of social responsibility of business;
- state the social responsibility of business towards different interest groups;
- explain the concept of business ethics; and
- understand the impact of Government Policy changes on Business and Industry.

3.1 MEANING OF BUSINESS ENVIRONMENT

As stated earlier, the success of every business depends on adapting itself to the environment within which it functions. For example, when there is a change in the government polices, the business has to make the necessary changes to adapt itself to the new policies. Similarly, a change in the technology may render the existing products obsolete, as we have seen that the introduction of computer has replaced the typewriters; the colour television has made the black and white television out of fashion. Again a change in the fashion or customers' taste may shift the demand in the market for a particular product, e.g., the demand for jeans reduced the sale of other traditional wear. All these aspects are external factors that are beyond the control of the business. So the business units must have to adapt themselves to these changes in order to survive and succeed in business. Hence, it is very necessary to have a clear understanding of the concept of business environment and the nature of its various components.

The term 'business environment' connotes external forces, factors and institutions that are beyond the control of the business and they affect the functioning of a business enterprise. These include customers, competitors, suppliers, government, and the social, political, legal and technological factors etc. While some of these factors or forces may have direct influence over the business firm, others may operate indirectly. Thus, business environment may be defined as the total surroundings, which have a direct or indirect bearing on the functioning of business. It may also be defined as the set of external factors, such as economic factors, social factors, political and legal factors, demographic factors, technical factors etc., which are uncontrollable in nature and affects the business decisions of a firm.



3.1.1 Features of Business Environment

On the basis of the above discussion the features of business environment can be summarised as follows.

(a) Business environment is the sum total of all factors external to the business firm and that greatly influence their functioning.

(b) It covers factors and forces like customers, competitors, suppliers, government, and the social, cultural, political, technological and legal conditions.

(c) The business environment is dynamic in nature, that means, it keeps on changing.

(d) The changes in business environment are unpredictable. It is very difficult to predict the exact nature of future happenings and the changes in economic and social environment. .

(e) Business Environment differs from place to place, region to region and country to country. Political conditions in India differ from those in Pakistan. Taste and values cherished by people in India and China vary considerably.

3.1.2 Importance of Business Environment

There is a close and continuous interaction between the business and its environment. This interaction helps in strengthening the business firm and using its resources more effectively. As stated above, the business environment is multifaceted, complex, and dynamic in nature and has a far-reaching impact on the survival and growth of the business. To be more specific, proper understanding of the social, political, legal and economic environment helps the business in the following ways:

(a) Determining Opportunities and Threats : The interaction between the business and its environment would identify opportunities for and threats to the business. It helps the business enterprises for meeting the challenges successfully.

(b) Giving Direction for Growth : The interaction with the environment leads to opening up new frontiers of growth for the business firms. It enables the business to identify the areas for growth and expansion of their activities.

(c) Continuous Learning : Environmental analysis makes the task of managers easier in dealing with business challenges. The managers are motivated to continuously update their knowledge, understanding and skills to meet the predicted changes in realm of business.

(d) Image Building : Environmental understanding helps the business organisations in improving their image by showing their sensitivity to the environment within which they are working. For example, in view of the shortage of power, many companies have set up Captive Power Plants (CPP) in their factories to meet their own requirement of power.

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(e) Meeting Competition : It helps the firms to analyse the competitors' strategies and formulate their own strategies accordingly.

(f) Identifying Firm's Strength and Weakness : Business environment helps to identify the individual strengths and weaknesses in view of the technological and global developments.

INTEXT QUESTIONS 3.1

1. Define the term Business Environment in your own words.
2. Rectify the following sentences if found incorrect.
   (a) The business environment is static in nature.
   (b) Business environment includes factors external as well as internal to business firm.
   (c) The changes in business environment are quite predictable.
   (d) Business environment helps the firm to identify the opportunities for the business.

3.2 TYPES OF BUSINESS ENVIRONMENT

Confining business environment to uncontrollable external factors, it may be classified as (a) Economic environment; and (b) Non-economic environment. The economic environment includes economic conditions, economic policies and economic system of the country. Non-economic environment comprises social, political, legal, technological, demographic and natural environment. All these have a bearing on the strategies adopted by the firms and any change in these areas is likely to have a far-reaching impact on their operations. Let us have a brief idea about each of these areas of business environment.

3.2.1 Economic Environment

The survival and success of each and every business enterprise depend fully on its economic environment. The main factors that affect the economic environment are:

(a) Economic Conditions : The economic conditions of a nation refer to a set of economic factors that have great influence on business organisations and their operations. These include gross domestic product, per capita income, markets for goods and services, availability of capital, foreign exchange reserve, growth of foreign trade, strength of capital market etc. All these help in improving the pace of economic growth.

(b) Economic Policies : All business activities and operations are directly influenced by the economic policies framed by the government from time to time. Some of the important economic policies are:

(i) Industrial policy

(ii) Fiscal policy

(iii) Monetary policy

(iv) Foreign investment policy

(v) Export–Import policy (Exim policy)

The government keeps on changing these policies from time to time in view of the developments taking place in the economic scenario, political expediency and the changing requirement. Every business firm has to function strictly within the policy framework and respond to the changes therein.

Important Economic Policies

(i) Industrial policy: The Industrial policy of the government covers all those principles, policies, rules, regulations and procedures, which direct and control the industrial enterprises of the country and shape the pattern of industrial development.

(ii) Fiscal policy: It includes government policy in respect of public expenditure, taxation and public debt.

(iii) Monetary policy: It includes all those activities and interventions that aim at smooth supply of credit to the business and a boost to trade and industry.

(iv) Foreign investment policy: This policy aims at regulating the inflow of foreign investment in various sectors for speeding up industrial development and take advantage of the modern technology.

(v) Export–Import policy (Exim policy): It aims at increasing exports and bridge the gap between export and import. Through this policy, the government announces various duties/levies. The focus now-a-days lies on removing barriers and controls and lowering the custom duties.

(c) Economic System : The world economy is primarily governed by three types of economic systems, viz., (i) Capitalist economy; (ii) Socialist economy; and (iii) Mixed economy. India has adopted the mixed economy system which implies co-existence of public sector and private sector.

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3.2.2 Non-economic Environment

The various elements of non-economic environment are as follow:

(a) **Social Environment :** The social environment of business includes social factors like customs, traditions, values, beliefs, poverty, literacy, life expectancy rate etc. The social structure and the values that a society cherishes have a considerable influence on the functioning of business firms. For example, during festive seasons there is an increase in the demand for new clothes, sweets, fruits, flower, etc. Due to increase in literacy rate the consumers are becoming more conscious of the quality of the products. Due to change in family composition, more nuclear families with single child concepts have come up. This increases the demand for the different types of household goods. It may be noted that the consumption patterns, the dressing and living styles of people belonging to different social structures and culture vary significantly.

(b) **Political Environment :** This includes the political system, the government policies and attitude towards the business community and the unionism. All these aspects have a bearing on the strategies adopted by the business firms. The stability of the government also influences business and related activities to a great extent. It sends a signal of strength, confidence to various interest groups and investors. Further, ideology of the political party also influences the business organisation and its operations. You may be aware that Coca-Cola, a cold drink widely used even now, had to wind up operations in India in late seventies. Again the trade union activities also influence the operation of business enterprises. Most of the labour unions in India are affiliated to various political parties. Strikes, lockouts and labour disputes etc. also adversely affect the business operations. However, with the competitive business environment, trade unions are now showing great maturity and started contributing positively to the success of the business organisation and its operations through workers participation in management.

(c) **Legal Environment :** This refers to set of laws, regulations, which influence the business organisations and their operations. Every business organisation has to obey, and work within the framework of the law. The important legislations that concern the business enterprises include:

(i) Companies Act, 1956

(ii) Foreign Exchange Management Act, 1999

(iii) The Factories Act, 1948

(iv) Industrial Disputes Act, 1972

(v) Payment of Gratuity Act, 1972

(vi) Industries (Development and Regulation) Act, 1951

(vii) Prevention of Food Adulteration Act, 1954

(viii) Essential Commodities Act, 2002

(ix) The Standards of Weights and Measures Act, 1956

(x) Monopolies and Restrictive Trade Practices Act, 1969

(xi) Trade Marks Act, 1999

(xii) Bureau of Indian Standards Act, 1986

(xiii) Consumer Protection Act, 1986

(xiv) Environment Protection Act

(xv) Competition Act, 2002

Besides, the above legislations, the following are also form part of the legal environment of business.

(i) Provisions of the Constitution : The provisions of the Articles of the Indian Constitution, particularly directive principles, rights and duties of citizens, legislative powers of the central and state government also influence the operation of business enterprises.

(ii) Judicial Decisions : The judiciary has to ensure that the legislature and the government function in the interest of the public and act within the boundaries of the constitution. The various judgments given by the court in different matters relating to trade and industry also influence the business activities.

(d) Technological Environment : Technological environment include the methods, techniques and approaches adopted for production of goods and services and its distribution. The varying technological environments of different countries affect the designing of products. For example, in USA and many other countries electrical appliances are designed for 110 volts. But when these are made for India, they have to be of 220 volts. In the modern competitive age, the pace of technological changes is very fast. Hence, in order to survive and grow in the market, a business has to adopt the technological changes from time to time. It may be noted that scientific research for improvement and innovation in products and services is a regular activity in most of the big industrial organisations. Now a days infact, no firm can afford to persist with the outdated technologies.

(e) Demographic Environment : This refers to the size, density, distribution and growth rate of population. All these factors have a direct bearing on the demand for various goods and services. For example a country where population rate is

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high and children constitute a large section of population, then there is more demand for baby products. Similarly the demand of the people of cities and towns are different than the people of rural areas. The high rise of population indicates the easy availability of labour. These encourage the business enterprises to use labour intensive techniques of production. Moreover, availability of skill labour in certain areas motivates the firms to set up their units in such area. For example, the business units from America, Canada, Australia, Germany, UK, are coming to India due to easy availability of skilled manpower. Thus, a firm that keeps a watch on the changes on the demographic front and reads them accurately will find opportunities knocking at its doorsteps.

(f) Natural Environment : The natural environment includes geographical and ecological factors that influence the business operations. These factors include the availability of natural resources, weather and climatic condition, location aspect, topographical factors, etc. Business is greatly influenced by the nature of natural environment. For example, sugar factories are set up only at those places where sugarcane can be grown. It is always considered better to establish manufacturing unit near the sources of input. Further, government's policies to maintain ecological balance, conservation of natural resources etc. put additional responsibility on the business sector.

INTEXT QUESTIONS 3.2

1. What is meant by Exim policy?
2. Identify the types of non-economic environment in the following cases:
   (a) Demand for new clothes increases during festive session.
   (b) Computer has outdated typewriter.
   (c) Coca-Cola is now being freely sold in the Indian market.
   (d) Sugar factories are being set up where sugarcane is grown abundantly.
   (e) Availability of skilled labour in a particular region.

3.3 RECENT DEVELOPMENTS IN INDIAN ECONOMY

The economic environment of business in India has been changing at a fast rate mainly due to the changes in the economic policies of the government. At the time of independence, the Indian economy was basically agrarian with a weak industrial base. To speed up the industrial growth and solve various economic problems, the government took several steps like state ownership on certain categories of industries, economic planning, reduced role of private sector, etc. The Government adopted several control measures on the functioning of private sector enterprises. All these efforts resulted a mixed response. There was growth in net national product, per capita income and development of capital goods sector and infrastructure. But rate of industrial growth was slow, inflation increased and government faced a serious foreign exchange crisis during eighties. As a result, the government of India introduced a radical change in economic policies in 1991. This policy abolished industrial licensing in most of the cases, allowed private participation in most industries, disinvestment was carried out in many public sector industrial enterprises and opened up the economy considerably. Foreign Investment Promotion Board was set up to channelise foreign capital investment in India. Let us discuss the developments under three heads, viz., (a) Liberalisation, (b) Privatisation, and (c) Globalisation.

(a) Liberalisation

Liberalisation refers to the process of eliminating unnecessary controls and restrictions on the smooth functioning of business enterprises. It includes:

(i) abolishing industrial licensing requirement in most of the industries;

(ii) freedom in deciding the scale of business activities;.

(iii) freedom in fixing prices of goods and services;

(iv) simplifying the procedure for imports and exports;

(v) reduction in tax rates; and

(vi) simplified policies to attract foreign capital and technology to India.

Through this liberalisation process, Indian Economy has opened up and started interacting with the world in a big way. This has resulted in easy entry of foreign business organisations in India. This has further resulted in stiff competition and efficiency. Ultimately, liberalisation has helped us in achieving a high growth rate, easy availability of goods at competitive rates, a healthy and flourishing stock market, high foreign exchange reserve, low inflation rate, strong rupee, good industrial relations, etc.

(b) Privatisation

Privatisation refers to reducing the role of public sector by involving the private sectors in most activities. Due to the policy reforms announced in 1991, the expansion of public sector has literally come to a halt and the private sector registered fast growth in the post-liberalised period. The issues of privatisation include:

(i) reduction in the number of industries reserved for the public sector from 17 to 8 (reduced further to 3 later on) and the introduction of selective competition in the reserved area;

(ii) disinvestment of shares of selected public sector industrial enterprises in order to raise resources and to encourage wider participation of general public and workers in the ownership in business;

(iii) improvement in performance through an MOU system by which managements are to be granted greater autonomy but held accountable for specified results.

In India, as a result of these steps, the post liberalisation phase has witnessed a massive expansion of the private sector business in India. You can have an idea of their expansion from the fact that the total capital employed in top 500 private sector companies rose from Rs. 1,39,806 crores in 1992-93 to Rs. 2, 34, 751 crores in 1994-95 (an expansion of 68% in just two years).

(c) Globalisation

Globalisation means 'integrating' the economy of a country with the world economy. This implies free flow of goods and services, capital, technology and labour across national boundaries. To achieve these objectives of globalisation, the government has adopted various measures such as reduction in custom duties, removal of quantitative restrictions or quotas on exports and imports, facilitating foreign investment and encouragement of foreign technology. These measures are expected to achieve a higher rate of growth, enlargement of employment potential, and reduction of regional disparities.

(d) Business Environment

Impact of Government Policy changes on Business & Industry with special reference to liberalization, privatisation and globalisation.

1. **Rapidly Changing Technological Environment :** After the introduction of new economic policy the companies were forced to adopt the world class technology. The reason is increase in competition.

2. **More Demanding Consumers :** Prior to government policy changes, consumers purchased goods and services without much inquiry. But now-a-days products are produced considering the demands of customers. Customers have started buying good quality goods and services.

3. **Increasing Competition :** Today, Indian companies have to face competition not only from the internal market but also from the MNCs. If the companies could not face the competition, they had to leave the market.

4. **Necessity for Change :** Before the government policy changes, the businesses were more stable. Policies once laid down were used to continue for a long time. But these days business environment is undergoing rapid changes so business enterprise have to modify their policies from time to time.

5. **Necessity for Developing Human Resources :** Prior to government policy changes, Indian companies were managed by inadequately trained personnel. New market situations demanded highly skilled and competent human resources. Hence, Indian companies started training and developing their human skills.

INTEXT QUESTIONS 3.3

1. What is meant by Globalisation?

2. Write 'L' for Liberalisation, 'P' for Privatisation and 'G' for Globalisation.

   (a) Freedom in fixing prices of goods and services. ☐

   (b) Disinvestment of shares of public sector industrial enterprises. ☐

   (c) Reduction in sales tax rates. ☐

   (d) Reduction in custom duties. ☐

   (e) Reduction in number of industries reserved for public sector. ☐

3.4 SOCIAL RESPONSIBILITY OF BUSINESS

Every business enterprise is an integral part of the society. It uses the scarce resources of the society to continue and grow. Hence, it is important that no activity of business is injurious to the long run interests of the society. However, it is observed that, in practice, there are a few socially undesirable aspects of business such as, polluting the environment, non-payment of taxes, manufacturing and selling adulterated products, giving misleading advertisement and so on. This has resulted in the development of the concept of social responsibility of business whereby the owners and managers of business are made conscious about the responsibilities of their business towards the community and its customers, workers etc.

3.4.1 Concept of Social Responsibility

Social responsibility of business means obligation to act in a manner which will serve the best interests of the society. Social obligation of a business is different from legal obligation legal obligation is observed because of the provisions or fear of law, but social obligations will help to take voluntary efforts on the part of business to fulfill the need of the society. By fulfilling the social obligations, business creates an environment which is conducive to its success.

Case for Social Responsibility

Business has social responsibility because of the following reasons :

1. **Self Interest :** Business can succeed in the long run by fulfilling the demands of the society. The people who have good environment, education and opportunities can become good employees, customers and neighbours of the business.

2. **Balancing of Social Power :** The decisions and activities of a business can affect the consumers, employees, environment and community. So it has social power. If social power and responsibility are not balanced, the business might use its power against the interests of consumers, employees, environment and community.

3. **Creation of Society :** Business is a creation of society as it uses the resources provided by the society. So it should utilise the resources for the benefit of people. A successful business can built a happy and satisfied community and employees.

4. **Social Awareness :** Now-a-days consumers are aware of the quality of various products, the market price of various products, the name of reputed companies supplying the product etc. Therefore, they should be given fair treatment by the business. Otherwise, they will organise and form Consumer Associations. This will compel the business to perform social obligations.

5. **Public Image :** If the business follows social obligations, public image will improve. The public will have credibility to the concern. Otherwise, conflict will arise between the business and society.

6. **Moral Justification :** Every business organisation uses human resources, physical resources and capital of the society. Roadways, power and water supply are used by business firms. The products of business units are sold to the society. Therefore, it is the moral responsibility of business to contribute for the well being of the society.

3.4.2 Responsibilities Towards Different Interest Groups

It needs to be noted that the responsibilities of those who manage the business cannot be limited to the owners. They have to take into account the expectations of other stakeholders like the workers, the consumers, the government and the community and public at large. Let us now look at the responsibilities of the business towards all these groups.

(a) **Responsibility towards the shareholders or owners :** The shareholders or owners are those who invest their money in the business. They should be provided with a fair return on their investment. You know that in case of companies it is in the form of dividends. It has to be ensured that the rate of dividend is commensurable with the risk involved and the earnings made. Besides dividends, the shareholders also expect an appreciation in the value of shares. This is governed primarily by company's performance.

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Funds required by the business are provided by investors. The responsibility of business towards owners or investors are as follows :

1. To ensure safety of investment.
2. To provide regular, correct and adequate information on the financial aspects.
3. To provide fair and regular dividend.
4. To ensure capital appreciation.
5. To protect the assets of the business.

(b) **Responsibility towards the Employees :** A business enterprise must ensure a fair wage or salary to the workers based on the nature of work involved and the prevailing rates in the market. The working conditions must be good in respect of safety, medical facilities, canteen, housing, leave and retirement benefits etc. They should also be paid reasonable amount of bonus based on the business earnings. Preferably, there should also be a provision for their participation in management

Without employees no organisation can survive. The brain, efforts, talent and expertise of employees bring success to business concerns. The responsibility of business towards its employees are as follows :

1. To provide reasonable and fair wages and salaries.
2. To maintain good working conditions for the good health of the workers.
3. To provide services such as housing, medical care, recreation etc.
4. To develop a sense of belonging.
5. To win the cooperation of the workers by creating better human relations in the business.

(c) **Responsibility towards the Consumers :** A business enterprise must supply quality goods and services to the consumers at reasonable prices. It should avoid adulteration, poor packaging, misleading and dishonest advertising, and ensure proper arrangement for attending to customer complaints and grievances.

The products produced by the business are used by consumers. The responsibility of business towards consumers are as follows :

1. To ensure regular supply of goods/services.
2. To provide goods at reasonable prices.
3. To provide goods which will help to meet the needs of consumers of different classes.

4. To provide goods of standard quality.

5. To ensure that advertisements made are true.

6. To provide prompt and continuous service.

(d) Responsibility towards the Government : A business enterprise must follow the guidelines of the government while setting up the business. It should conduct the business in lawful manner, pay the taxes honestly and in time. It should not indulge in any corrupt practices or unlawful activities.

The responsibilities of business towards government are as follows :

1. To abide by the laws of the nation.

2. To pay taxes honestly and in time.

3. To refrain from corrupting government employees.

4. To discourage the tendencies of concentration of economic power and monopoly.

5. To adapt fair dealings in foreign trade.

(e) Responsibility towards the Community : Every business is a part and parcel of our community. So it should contribute towards the general welfare of the community. It should preserve and promote social and cultural values, generate employment opportunity and contribute towards the upliftment of weaker sections of the society. It must take every step to protect the physical and ecological environment of the society. It should contribute to the community development programmes like public health care, sports, cultural programmes.

Business should work for the community. The main responsibility of business towards the public are as follows :

1. To protect the environment from pollution.

2. To provide better employment opportunities.

3. To preserve social and cultural values.

4. To help the weaker sections of the society like disabled persons, widows, scheduled tribes etc.

5. To promote national integration.

Looking at the importance of the social responsibilities of business towards various groups, it would have been better if the companies act provided for the reporting of the social activity in the annual report of the companies. However, a few large companies

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have been voluntarily reporting their social performances in their Annual Reports regularly. The prominent among them are Cement Corporation of India, Indian Oil Corporation, Tata Steels, Asian paints and ITC. These reports reveal that companies are becoming eco-friendly and conscious of their role in community development.

3.4.3 Business and Environmental Protection

The health of plants and animals depend on the quality of environment in which they live. Rapid industrialisation, evolvement of fast food centres and traffic have caused much damage to the environment. Forests and wild life are declining very fast because of the construction of large number of factories and apartments for their employees. Therefore, air, noise and water pollution increased. Governments have framed laws to prevent pollution. Pollution Control Boards have been set up by Central and State governments.

Causes of Environmental Pollution

Environmental pollution arises due to the following causes :

1. **Air Pollution :** Air pollution is the result of a combination of factors which decreases the air quality. Carbon monoxide emitted by automobiles contributes to air pollution.

2. **Water Pollution :** Chemical waste from factories is polluting the water bodies of every country. Throwing of plastic bags filled with flowers and other materials plastic bottles etc. pollute our rivers, streams and lakes.

3. **Land Pollution :** Excessive useage of pesticides in agriculture has damaged our devine land. People go for shopping every day and have the habit of buying in plastic bags. People throw these plastic bags here and there causing pollution of soil.

4. **Noise Pollution :** Running of factories is a source of noise pollution. Automobiles also cause noise pollution. Noise pollution may cause mental disorder, loss of hearing, malfunctioning of heart etc.

Need for Pollution Control

Pollution control is required because of the following reasons :

1. To reduce safety hazards and to ensure safety of life.
2. To reduce risk of liability to pay compensation to people.
3. To protect public health.
4. To reduce inconveniences like water pollution (which will affect fishes and other water plants), human health hazards such as breathing difficulty, irritation in eyes etc.
5. To save cost of cleaning the land and machines.

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3.5 BUSINESS ETHICS

Business Ethics means the business practices which are desirable from the point of view of the society. i.e. the moral principles which should be followed by business.

Business ethics are concerned with determining what is right and what is wrong while doing the business. By ethics we mean the business practices which are desirable from the point of view of the society.

A few examples of ethical business practices are :

1. To charge fair prices from the customer.
2. To use fair weights for commodities.
3. To pay taxes to government correctly and promptly.
4. To ensure supply of safe products for the public.
5. To give fair treatment to the workers.
6. Not to indulge in unfair trade practices, mal practices, black marketing and hoarding.

3.5.1 Elements of Business Ethics

The elements of business ethics are as follows :

1. Business ethics create selfimposed discipline on the part of the business firms.
2. Business ethics make a business honest and responsible.
3. Business ethics aims at fair and reasonable treatment to customers, employees, suppliers etc.
4. Business ethics co-exist with law which will help in the perfection of the conduct of life.
5. Business ethics covers all business practices which are desirable from the point of view of the society.

INTEXT QUESTIONS 3.4

1. State the meaning of 'business ethics'.
2. Identify the group towards which the business is responsible.
   (a) When the organisation pays the taxes in time.
   (b) When the company produces good quality products and sells it at reasonable price.

(c) When the company organises sport meet for the general public for a particular locality.

(d) When the company declares dividend at a higher rate.

(e) When the organisation provides proper medical facility to the staff members.

3. Multiple choice questions:

i. Identify from the following the ethical practices in business.

a) Exploitation of workers   b) Selling adulterated food.

c) Honesty in dealing with consumers   d) Sale of duplicate goods

ii. Which of the following is not ethical practice :

a) Prompt payment of taxes by business

b) Sell products with correct measurement

c) Black marketing

d) Providing fair wages to workers.

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WHAT YOU HAVE LEARNT

- The term 'business environment' connotes external forces, factors and institutions that are beyond the control of the business and they affect the functioning of business enterprises. These include customers, competitors, suppliers, government, and the social, political, legal and technological factors etc. Business environment is multifaceted, complex, and dynamic in nature. The changes in business environment are unpredictable. It differs from place to place, region to region and country to country.

- **Importance of Business Environment:** The interaction between the business and its environment helps in identifying the opportunities for and threats to the business. it open up new frontiers of growth for the business firms. Environmental analysis makes the task of managers easier in dealing with business challenges. It helps the firms to analyse the competitors' strategies and formulate their own strategies accordingly keeping in mind its own strength and weakness.

- Types of Business Environment

  (a) Economic environment : (i) Economic Conditions; (ii) Economic Policies; (iii) Economic System

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(b) Non-economic environment : (i) Social Environment; (ii) Political Environment; (iii) Legal Environment; (iv) Technological Environment; (v) Demographic Environment; (vi) Natural Environment

- Recent Developments in Indian Economy

  (a) **Liberalisation:** Liberalisation refers to the process of eliminating unnecessary controls and restrictions on the smooth functioning of business enterprises.

  (b) **Privatisation :** Privatisation refers to reducing the role of public sector by involving the private sectors in most activities.

  (c) **Globalisation :** Globalisation means 'integrating' the economy of a country with the world economy. This implies free flow of goods and services, capital, technology and labour across national boundaries.

- **Social Responsibility of Business :** Social responsibility of business refers to the obligation of business enterprises to adopt policies and plans of actions that are desirable in terms of the expectation, values and interest of the society. It ensures that the interests of different groups of the public are not adversely affected by the decisions and policies of the business.

- **Social Responsibilities Towards Different Groups**

  (a) Responsibility towards the shareholders or owners

  (b) Responsibility towards the Employees

  (c) Responsibility towards the Consumers

  (d) Responsibility towards the Government

  (e) Responsibility towards the Community

- **Business Ethics :** Business ethics are the moral principles, which guide the behaviour of businessmen or business activities in relation to the society. It provides certain code of conduct to carry on the business in a morally justified manner.

- Social responsibility means obligation of business to care for the interests of society.

- Arguments in favour of social responsibility : self interest, balancing of social power, creation of society, social awareness, public image and moral justification.

- Business has the responsibility towards investors like ensuring safety of investment, provide correct information, provide fair dividend and to protect the assets of the business.

- Business has the responsibility towards consumers like ensure regular supply of goods, provide goods at reasonable price, provide goods to meet the needs of consumers of different classes, provide goods of standard quality etc.

- Responsibility towards employees are to provide fair wage/salaries, maintain good working conditions, provide housing and recreation facilities, to win the cooperation of workers etc.
- Responsibility of business towards government include to pay taxes promptly, to refrain from corruption, to adapt fair dealings in foreign trade and to discourage the tendencies concentration of economic power.
- Responsibility towards community include protection of environment, better employment opportunities, pressure social and cultural values, help weaker sections of the society and to promote national integration.
- Air pollution, water pollution, land pollution and noise pollution are the cause of environmental pollution.
- Business ethics means moral behaviour on the part of businessmen.
- Elements of business ethics include – discipline, honesty, fair and reasonable treatment, perfection in the conduct of life and desirable business practices.

KEY TERMS

Business Ethics	Legal Environment	Social Environment
Demographic Environment	Liberalisation	Social Responsibility of Business
Economic Environment	Natural Environment	Technological Environment
Economic Policy	Political Environment	
Globalisation	Privatisation	

TERMINAL EXERCISE

Very Short Answer Type Questions

1. State any two features of business environment.
2. Mention the different types of business environment.
3. List the various elements of non-economic environment of business.
4. State any two effects of liberalisation of Indian economy.
5. What is meant by the term ‘ethics’?
6. What do you mean by social responsibility of business?
7. What do you understand by ‘business ethics’?
8. State any two responsibilities of business towards consumers.

9. Mention any two causes of environmental pollution.
10. State any two elements of business ethics.
11. Give two examples of business ethics.

Short Answer Type Questions

12. How does demographic environment of business influence the business activities.
13. What are the steps Government of India has taken as a part of its liberalisation process.
14. Explain the effect of political environment in the normal functioning of business enterprises.
15. Why should a business enterprise be socially responsible?
16. What are the effects of Globalisation of Indian economy?
17. Briefly explain the concept of social responsibility.
18. Enumerate the responsibilities of business towards employees.
19. Give any four arguments in favour of social responsibility.
20. What do you mean by the term 'business ethics'.

Long Answer Type Questions

21. Describe the importance of business environment for the business firm.
22. Explain any two non-economic environment of business.
23. What is meant by social responsibility of business? State the responsibilities of business towards the community.
24. Describe in brief the economic environment of business.
25. Explain the social responsibility of business towards different groups.
26. What are the responsibilities of business towards investors, consumers and employees?
27. What do you mean by social responsibility? Explain some points favouring social responsibility of business.
28. What do you mean by business ethics? Give three examples. Which are the elements of business ethics? Explain briefly.
29. **"Knowledge of Business Environment helps the businessmen to understand the opportunities for and threats to the business." In the light of this statement explain the importance of Business Environment that helps to Businessmen to prepare future plans.**
30. **"Business has to take into account the expectations of various stakeholders like the workers, the consumers, the Government and the community." Comment on this statement with the explanation of Social Responsibilities of business.**

ANSWERS TO INTEXT QUESTIONS

3.1 2. (a) The business environment is dynamic in nature.

(b) Business environment includes factors external to business firm.

(c) The changes in business environment are quite unpredictable.

(d) Correct statement.

3.2 1. Exim policy regulates the import and export of our country. Through this policy Government decides the duties or taxes on import of goods and services.

2. (a) Social environment

(b) Technological environment

(c) Political environment

(d) Natural environment

(e) Demographic environment

3.3 1. Globalisation means integrating the economy of a country with world economy. It implies free flow of goods and services, capital, technology and labour across the national boundaries.

2. (a) L (b) P (c) L (d) G (e) P

3.4 1. Business ethics means the relationship between the society on one hand and business activities on the other. The objectives, practices, techniques and behaviour of business must be in conformity to the standards set by the society.

2. (a) Responsibility towards Government

(b) Responsibility towards Consumer

(c) Responsibility towards Community

(d) Responsibility towards Owners/shareholders

(e) Responsibility towards Employees

3. (i) c (ii) c

DO AND LEARN

1. Visit the market place, post offices, banks and other places of your locality and make note of the changes that have taken place due the change in Information Technology.

2. Find out the raw materials being available in abundance in your area. How many industries or business units are set up based on it? Prepare a report.

Notes

ROLE PLAY

1. Satish belongs to a rural area. Once he had gone to the nearest town. He saw there a very big and well maintained park. Inside the park he read a small board - 'This Park is maintained by KCS Ltd'. He tried to recall where did he read this name before? He remembered that the charitable hospital of his village was also run by KCS Ltd. He was filled with curiosity. He decided to find out more about all this. One day he met his friend's father. Mr. K. Mohan.

   Satish : Good Morning Uncle.

   K. Mohan : Good Morning Satish? How are you?

   Satish : Very fine! How about you?

   K. Mohan : Great! What brings you here son?

   Satish : Uncle, if I remember rightly you are in a company called KCS Ltd, right?

   K. Mohan : You are right. I am working as General Manager (Administration). But why?

   Satish : Uncle! Today when I went to the park, I observed that the company KCS Ltd. maintains the park and so also the charitable hospital in my village. Well, why should a company divert its attention from its regular activities and indulge in an activity which only increases its expense?

   K. Mohan : Well, all these are taken up by the company as a part of it responsibility towards the community, and it is called Social Responsibility of a company.

   Satish : Social Responsibility? What is that?

(Mr. K.Mohan explained to Satish about the concept of social responsibility of business.) Now, you are required to continue the conversation by assuming a role for yourself and one for your friend.

2. Rahul, a trade union leader, discussed in one of the meetings with his followers, about the problems they faced while performing duties in the factory.

   Workers : Informed Rahul about problems of working hours, bad working conditions, housing, recreation etc.

   Rahul : No problem, I will talk to the manager and shall explain him about social responsibilities of business towards workers, society, Government and so on.

Assuming the discussion of Rahul & Manager of factory please continue the discussion on social responsibility, which manager is performing to discharge his duties towards different interest groups.

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4

MODERN MODES OF BUSINESS

You know that normally, to buy goods and services we visit the nearby market, to book the train tickets we go to the rail reservation counters, to make deposits and withdrawals of money we visit banks personally, and so on. But, now-a-days all these facilities are available at our doorstep. The Information and Communication Technology (ICT) has made it a reality. It has brought about a formidable change in the mode of transacting the business activities. There is no need to stand in long queues in the banks and rail reservation counters. All these transactions are now being done with the help of Internet. We can visit the world market at any time just sitting at our home. We can avail of many facilities without visiting the shops or the market physically. All these developments are the result of the changes in the economic policies effected by the government. One of the major advantages that India gained due to globalisation has been our introduction to the world of technology. The Multinational Corporations (MNCs) got an opportunity to explode the Indian market with its modern science and technology. However, India took no time to adapt the changing technology and emerged as a successful player in the world market. In addition to the technological revolution, another concept successfully introduced in the Indian market has been the 'Outsourcing of Services' or 'Business Process Outsourcing' (BPO). It has helped the business firms to concentrate on their core competencies. In this lesson we shall learn in details about all these modern modes of business.

OBJECTIVES

After studying this lesson, you will be able to:

- explain the various mode of business;
- describe the facility of Internet and its uses;
- explain the concept of e-Commerce and e-Business;

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- outline the benefits and limitations of e-Commerce and e-Business;
- identify the stages involved in the trading process in on-line transactions;
- describe the precautions to be taken to ensure security in on-line transactions;
- explain the various applications of e-Commerce such as e-Banking, e-Ticketing, e-Advertising, e-Post; and
- explain the concept of outsourcing of services, its merits and limitations.

4.1 MODES OF BUSINESS

As stated earlier, to buy goods and services we usually go to a nearby market personally where buyers and sellers get together for transactions. The buyers check the quality and bargain the price. The sellers, on the other hand, try to persuade the prospective buyers and finalise the transaction. Sometimes, we contact the sellers over telephone or through correspondence to buy the specific goods. These are the common modes of business transactions. However, of late, the virtual market mode is gaining momentum. Through this mode, people get their desired goods and services sitting at their own place without actually visiting the market place. This has been made possible through introduction of information technology. The activities of production, marketing, selling, banking, insurance etc. are all carried on at a faster speed through the use of computers and Internet. When all these activities are carried on electronically it is commonly referred to as 'Electronic Business' or 'e-Business'. Since Internet plays an important role in all e-Business activities, let us first acquaint ourselves with Internet before we learn as to how it is helpful in carrying on business transactions.

4.2 INTERNET

The Internet, sometimes called simply the 'net', is a worldwide system of computer network through which the users at any computer can access the information from other computers. It provides information regarding science and technology, history, politics, sports, business, current events, music, entertainment, news and many more topics. It helps the users in the following ways:

(a) Browse the information on any topic through the World Wide Web (www).

(b) Read news available from leading newspapers and television channels.

(c) Exchange messages using e-mail.

(d) Search databases of government, individuals and private organisations.

(e) Transfer files, pictures, animations etc.

(f) Communicate with others by chatting or talking to them personally when both of them are connected to the Internet.

(g) Browse and search the catalogues of goods and services and purchase items on-line.

(h) Set up a website with information about products and services of your organisation.

The Internet was conceived by the Advanced Research Projects Agency (ARPA) of U.S. Government in 1969 as a military project and was known as ARPANET. It developed as an academic and research network. Later on, it was opened for use by members of public and commercial use. In the year 1979, it was called Internet. It has now evolved into a global network.

4.3 ELECTRONIC COMMERCE

You know that commerce involves buying and selling and support services like transport, insurance, banking, communication etc. When all these activities are undertaken using information and communication technologies, it is termed as Electronic Commerce or e-Commerce. In other words, e-Commerce refers to the process of conducting business with the help of electronic devices using the computer and interconnected telecommunication network. Here, offer for sale and its acceptance are made electronically through Internet. It does not require physical interaction between the parties concerned. It is also known as 'on-line trading', 'on-line shopping' and 'e-shopping'.

e-Commerce takes place between companies i.e., business to business (B2B), between companies and their customers (B2C), and customer to customer (C2C).

B2B refers to interactions between a manufacturer and a supplier of materials and services, or between a manufacturer and a wholesaler, or between a wholesaler and a retailer. A network of computers is used for making enquiries seeking or placing orders, communicating supply of goods, making payments, and so on.

B2C, as the name implies, have business firms (manufacturer or retailers) at one end and its consumers on the other. It enables a business firm to be in touch with its customers on round the clock basis. It involves a wide range of marketing activities including promotion, seeking orders, intimating supply and so on.

C2C usually involves consumers at both ends dealing in goods for which there is no established market mechanism as is the case with used books and household equipments.

INTEXT QUESTIONS 4.1

1. Define the term Internet.
2. State the full form of the following.

   (a) www (b) B2B (c) B2C (d) C2C

4.4 ELECTRONIC BUSINESS

Normally, one may use the terms 'e-Commerce' and 'e-Business' interchangeably. But, in practice, the term e-Business is used in a broader sense. The e-Business covers not only the interaction with its customers and suppliers but also interactions and dealings among various departments and persons within the firm. Thus, e-Business is a wider term which includes e-commerce and other electronically conducted business functions like production, accounting, finance, personnel, administration etc. In other words, e-Business includes not only B2B, B2C, and C2C but also **Intra-B Commerce** i.e., interaction and dealings among various departments and persons within the firm. For example, the marketing department may interact regularly with the production department and get the products made as per the requirements of the customers. Similarly, regular interaction among other departments helps in attaining efficient inventory handling, better cash management, proper utilisation of manufacturing capacity, timely and sufficient provision of customer services, and so on. Thus, e-Business implies use of Internet technologies to perform the key business processes.


4.5 BENEFITS OF E-COMMERCE/E-BUSINESS

The merits of e-Commerce/e-Business can be summarised as follows:

(a) Wider Accessibility : With the help of a well-developed computerised networking system, the business units can operate at the national as well as the global level. The buyers and sellers from any part of the world can interact with each other. This helps in gaining exposure to new markets.

(b) Improved Customers Service : E-Commerce enables a company to be open for business whenever a customer needs it. Up-to-date information about products can be offered on the web, making it easier and convenient for customers to select the best product. It also enables suppliers of goods and services to offer a wide range of services to the customers, before as well as after sale, and respond to customers' queries without any delay.

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(c) **Shortened Transaction Time :** An e-Business transaction takes much less time as compared to the normal process of buying and selling because the producers are able to cut short the distribution channels and establish direct contact with the consumers. It also enables a company to introduce a new product into the market, gain customers' reaction quickly, implement the necessary changes without incurring heavy cost and loss of time.

(d) **Cost Saving and Low Prices :** There is a substantial cost saving in business transactions through e-Commerce as there is hardly any display of goods involved and need for large stocks in godowns. The number of employees required is also limited. For example, as the orders are directly put into the system there is no need for any sales persons or order entry clerk. This helps in substantial savings in operational costs and offers products at lower prices to customers.

(e) **Enlarge Business and Profits :** With e-Commerce, the companies are able to approach a larger number and variety of customers and gain exposure to new markets. This enables them to enlarge their business volume and earn more profits.

(f) **Convenience to Customers :** The customers also stand to gain by e-Commerce in various ways. They have access to a large number of suppliers, enjoy a wider choice, and acquire quality products and services at competitive prices. They also receive prompt and efficient service and gain information about new products easily.

4.6 LIMITATIONS OF E-COMMERCE/E-BUSINESS

A few limitations of e-Business/e-Commerce are:

(a) It lacks personal touch with customers, which makes it unsuitable for items such as clothes, jewellery, etc.

(b) The web can provide a good picture, a detailed description of the product, but the customer cannot actually see, feel or try on the goods he/she is buying.

(c) The transaction can be finalised quickly, but physical delivery of goods often takes long time and be delayed. This leads to a lot of inconvenience for the customers.

(d) Return of faulty goods bought on-line may often be more problematic and a time consuming exercise.

(e) Shopping through Internet is not the same experience as a shopping expedition with family or friends. It is not suitable for non-routine buying where one is usually guided by advice of friends and family members.

(f) Online transactions are prone to a number of risks that can result into financial, reputational or psychological losses to the parties involved in a transaction. The

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risks relate to (i) the transaction (default in order taking, default in delivery, default in payment); (ii) data storage and transmission; and (iii) privacy. Moreover, the privacy of personal details and security of financial transactions are a concern for many users.

It may be noted that most of the above limitations are applicable to B2C commerce. As for the business buying i.e., B2B e-Commerce, these limitations have little relevance as both the parties are sufficiently knowledgeable, resourceful and well informed, and transact regularly with each other. No supplier therefore, can afford mishandling of any transaction with its business customers. However, there are some challenges, which will have to be overcome. These are: (i) lack of adequate Internet infrastructure; (ii) delivery and payment related issues; and (iii) absence of cyber laws.

INTEXT QUESTIONS 4.2

1. What is meant by Intra-B Commerce?
2. Enumerate the limitations of B2C e-Commerce.
3. Identify the merits and limitations of e-business from the following statements.
   (a) It lacks personal touch in business transactions.
   (b) It takes less time to give order for desired goods and services.
   (c) The customers have access to a large number of suppliers and they enjoy a wider choice.
   (d) It helps the business houses to expand the business and earn more profit.
   (e) The privacy of personal details and security of financial transactions are a concern for many users.

4.7 THE TRANSACTION PROCESS

As with any trading processes, the on-line transactions involve the following stages:

(a) Search : For making a purchase, the prospective customer has to find an appropriate vendor by using various web sites, either directly or through a search engine.

(b) Order : Once the vendor has been found and goods are identified, the customer makes contact and negotiates the terms. When satisfied, the customer proceeds to the checkout that involves filling up a registration form to have an account with a password. Thereafter, he can place the order for the items put by him in his virtual shopping cart, an on-line record of what has been picked up while browsing the on-line store.

(c) **Payment :** The normal way for paying on-line purchases is by the credit card. The customer enters the credit card numbers, expiry date and billing address on the order form, and the vendor can verify the details. Debit cards, or store's value cards can also be used for the purpose. Alternatively, payments can be made by cheques sent by post.

(d) **Delivery :** Once the payment is made or is assured, the vendor arranges for delivery of goods as per instructions of the buyer.

(e) **After Sales Service :** In any transaction, there can be problems like damaged or faulty goods. For items such as machinery or consumer durables, there can be a provision of warranty or maintenance. The e-Vendors have to make the necessary arrangements for attending to such complaints and services.

4.8 PRECAUTIONS FOR SECURITY

There are numerous threats to the security of e-Commerce from the customer's side as well as the vendor's side. The following steps are usually taken to ensure security in on-line transactions.

(a) **Passwords :** In on-line shopping, one has to register with the on-line vendor to have an account with him. This provides for a password to avoid login by an unauthorised person.

(b) **Authentication :** Sender of the message must be identified precisely using the off-line validation, if necessary. This avoids any possibility of fraud or misuse of the password.

(c) **Encryption :** It refers to the conversion of data into a code so that it cannot be read by other users. The data is converted into the code by the sender and then decoded by the receiver. For this purpose, they use an encryption algorithm and binary numbers. The other alternative is the private (secret) key system.

(d) **Digital Signatures :** A digital signature may be used to authenticate the sender of the message and check the integrity of the message so that no alteration takes place in transit. In terms of transmission, authentication and integrity, the digital signature is considered very secure provided it is created in a manner or by using a means under the exclusive control of the person using it.

(e) **Trusted Third Parties :** Another way to ensure security is to transmit a copy of the transaction to a third party trusted by both sides and where the record of the transaction could be used to settle any dispute.

However, the provision of encryption, digital signatures and trusted third parties cannot provide full proof security against the use of stolen credit cards or the setting up of fraudulent web site by a bogus trader. Hence, the parties have to be highly vigilant and take all possible precautions to ensure security in e-Commerce dealings, whatever may be the cost.

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INTEXT QUESTIONS 4.3

1. Mention the various ways of making payment in on-line transactions.
2. Arrange the following stages of on-line transactions in proper sequence.

   (a) Order (b) Delivery (c) Payment

   (d) Search (e) After sales services

4.9 APPLICATIONS OF E-COMMERCE

The impact of e-Commerce has already begun to appear in all areas of business ranging from customer service to new product design. It has facilitated new types of information based interaction with customers, Internet bookshops, on-line super market, electronic newspapers, on-line trading on stock exchanges (e-Trading), on-line advertising (e-Advertising), on-line taxation (e-Taxation), online ticketing (e-ticketing), online banking (e-Banking), computerisation in postal communication (e-Post) and so on. We shall take up some of these e-Commerce services to have an idea of how it has transformed the functioning in these sectors.

4.9.1 e-Banking

Imagine the days when one had to go to the bank during a particular time of the day and on particular days of a week to deposit or withdraw money or to get a demand draft made. Long queues and waiting were the normal phenomena. But, the scenario in banks now-a-days is very different. One can withdraw and deposit money at his/her own convenience. Having account in one place in India, one can transact in any part of the country. Some of the new trends in banking sector are as follows:

(a) **Telebanking :** A customer is given a password number (known as T-PIN i.e., Telephonic personal identification number) through which he can have access to his/her account over telephone and give instruction regarding withdrawal, issue of demand draft etc. The customer can also access his account and give instructions by using the mobile phone. Similarly, the bank can also keep on informing the customer regarding the various schemes, opportunities, last dates, etc. and attend to balance enquiries by the customers.

(b) **Internet Banking :** This is another way a customer can have access to his account and give instructions. It makes the task of the customer easy as he can access his account anywhere, any time and any number of times. The customer simply uses a password number and gets the details of transactions sitting at home.

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(c) **ATM :** ATM, the acronym for Automated Teller Machine, is increasingly becoming popular in banking industry. ATM is a computerised machine used for most of the routine jobs of a bank. It is operated by a magnetic plastic card popularly known as ATM card. By inserting the ATM card in the machine and entering the PIN (Personal Identification Number) the customer can use it for withdrawals and deposits of money. The customer can also get the information about the balance available in his/her account, get the mini-statement of last 5/10 transactions from the ATM.

Earlier the customers only had the option to access the ATM of the bank in which they had an account. But now-a-days some banks have tied-up with other banks for use of their ATM by the customers. So customers can use the ATM facility even of a bank they do not have an account in, but with whom their bank has a tie-up.

(d) **Debit Card :** A debit card is an electronic card that can be used conveniently while making payments. This card is issued to the customers of the bank having current or savings deposit account. The holder of this card can use this card at several outlets for purchase of goods and services. This card allows the holder to spend upto the balance available in his/her bank account. It can also be used at ATMs just like ATM cards.

(e) **Credit Card :** Some banks issue credit cards to individuals who may or may not have an account with them. The cards are issued to individuals after verifying their credit worthiness. The individual can use those cards at various outlets to make payments. The issuing bank fixes a credit limit upto which the cardholder can purchase goods and services. The bank issues a statement of transactions periodically and the individuals have to pay back the amount to the bank by a due date. Thus, the customers get a credit period ranging from 10 to 55 days which varies from bank to bank and the nature of transactions made. No interest is charged if the payment is made within the due date. If the customers fails to pay back by due date, the bank charges interest at a high rate on the amount due. Most banks give bonus points for transactions and insurance coverage for the products purchased through credit card as well as to the cardholders. The cardholder can also use his/her card to withdraw cash from ATMs.

INTEXT QUESTIONS 4.4

1. Mention the benefits of ATM for the customers of the bank.
2. Identify the following in e-banking transactions.
   (a) A card that allows the holder to spend money without having any balance in his/her deposit account.

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(b) A machine using which we can withdraw money from our deposit accounts at our convenience.

(c) A system that allows the account holder to avail the banking facility over telephone.

(d) A convenient way of accessing the account anytime, anywhere and any number of times.

4.9.2 e-Ticketing

Purchasing tickets has become so easy now that you can make railway reservations while sitting at home or even while you are on the move. If you have access to Internet you can have all the details of railway information and accordingly you can book a ticket. You have to make payment through credit cards/debit cards for on-line booking of tickets. You can also buy air tickets through similar methods. Recently, with private sector entry in aviation sector, the competition has increased and bidding of air tickets through Internet has started. The highest bidder avails the opportunity of travelling at a rate much lower than the original price. The e-Ticketing service is also available through mobile phones.

4.9.3 e-Advertising

Internet advertising has revolutionised marketing strategies. Unlike the print and television media where all advertisements are stacked together, the viewer has the choice either to view it or ignore them. Where as in the net-world the surfer will only click on the advertisement of his/her choice.He may select advertisements of his own interest. E-Advertising is still in its infancy stage and covers only a small portion of the advertising market.

4.9.4 e-Trading at Stock Exchanges

On line trading started with the establishment of OTCEI. Now the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) have also completely switched over to on-line trading to which most stock-brokers have access through internet. It is also taking off among small investors and traders in stock and shares. Internet makes available to them up-to-the-minute information which, until recently, had only been available to financial institutions. The use of on-line brokerage services automates the process of buying and selling. This allows reduction in brokerage charges, makes trading transparent as they can access the information on market prices on-line, and the investor is able to deal at a price viewed immediately. The transfer of ownership of stocks and shares can also be recorded electronically in investor's Demat accounts thereby avoiding the need for physical delivery. This has also made it possible to have rolling settlement and reduce the settlement period to just 2 days.

4.9.5 Computerisation of Mail Transmission and Processing

As a part of modernisation programme, computerisation of the registration and sorting work has been done in a large number of post offices in India. To cut down the transmission time for sending money order across the country, money orders are now transmitted through VSAT satellite networks which has resulted in faster delivery of money order to the customers. New policy for Voice mail/Audio fax services was announced in July 2001 by incorporating a new service known as Unified Message Service (UMS), a system by which voice message, mails, fax and e-mail can be received from one mail box using telephone instrument, fax machines, mobile phones, internet browsers, etc.

4.9.6 e-Post

You know about e-mail which is the fastest means of communication. To send and receive any information through e-mail, we need to have a computer with Internet connectivity and the e-mail account of the sender and receiver. However, this technology has not yet reached the rural and other remote areas of our country. To bridge this gap and extend the benefit of the e-mail facility to the people of rural India, the Department of Post has introduced e-Post facility. It enables people to send and receive e-mail at the post offices.

e-Post is a service under which printed or even handwritten messages are transmitted as email on internet. At the destination post offices, these messages are printed, enveloped and delivered through the postman like other letters. For this purpose, e-Post centres have been set up in the post offices in all districts and major towns. The post offices where this facility is not available can receive the e-Post message from the customers and forward the same to the nearest e-Post centre for despatch. Similarly e-Post messages received for areas beyond the delivery jurisdiction are printed and sent to concerned post office for delivery. Besides availing e-Post services through post office it can also be accessed from a customer's house or office or from any other places if he has Internet access. The customer can make payment through a prepaid card that is available in the head post office and other outlets. The customer has to register as a user and access the service at the e-Post portal http://indiapost.nic.in. The present tariff for sending the message in A4 size page is Rs.10 per addressee.

4.9.7 Resources Required for Successful E-business Implementation

Following resources are required for successful e-business implementation :

1. **A Website :** A business must develop a website to effectively communicate with its customers. Detailed information of the enterprise should be provided on the website. Necessary pictures should also be posted on the website.

2. **Technically Qualified Workforce :** E-business can be successful only with a well trained workforce. The workers should be capable to handle easily the new trends in computers. Sales Department staff should be trained to handle sales inquiries, processing orders and ensuring prompt delivery.

3. **Adequate Computer :** The business enterprise must own computers with adequate speed and memory to handle the expected volume of business. Business concerns must have the necessary Internet Service Provider (ISP) and Application Service Provider (ASP), Server and Portals, and e-mail facilities.

4. **Effective Telecommunication System :** Good telephone lines with high quality voice calls must be there to make e-business effective. Business firms will be badly affected if the telephone lines get disconnected frequently.

5. **Payment Mechanism :** Adequate information must be provided on the website so that customers will have idea of the exact amount to be paid. If extra amount is received, inbuilt systems should be created to refund the extra money received. Business concerns must make arrangements with banks and credit card agencies to enable electronic receipts and payments of money.

4.9.8 Payment Mechanism of Online Transactions

1. **Finding the Seller :** Buyer will go through the website of the seller. Online shopping buyer has to register with online seller by filling up a registration form. Registration means buyer will create an 'account' with online seller by providing a 'password'.

2. **Selection of Products :** Buyer selects the products after comparing prices and quality offered by other sellers.

3. **Placing an Order :** While browsing the website, the buyer drop the items selected in his shopping cart. Shopping cart is an online record of the items picked up by the buyer while browsing the website.

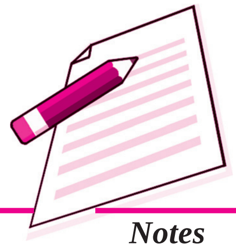
4. **Payment Mechanism :** Payment for the purchases through online shopping may be done in any of the following ways :

   a) **Cash on Delivery (COD) :** The payment for goods ordered online may be made in cash at the time of physical delivery of goods.

   b) **Cheque :** The buyer may send a cheque to the online vendor. The delivery of goods are made upon the realisation of cheque.

   c) **Net-banking transfer :** Buyer may transfer the amount for the agreed price of the transaction to the account of the on-line vendor.

   d) **Credit/Debit Card :** In case of Credit Card, the buyer can make purchases on credit. Issuing bank tranfers the amount involved in the transaction to the credit of the seller and debit the buyer's account.



The debit card allows purchases up to the specified amount that is Buying in his account. (available balance)

e) **Digital Cash :** This is a form of electronic currency that exists in cyber space. In favour of the customer the bank issues digital cash for the amount he paid. Bank will supply a special software that will allow the customer to draw digital cash from his account. Digital cash is used for purchases over the web.

5. **Delivery :** The product is given to the buyer after receiving the payment.

4.9.9 Security and Safety of e-transaction : e-business Risks

Risks are involved in online transactions. There can be financial, reputational or physiological losses to the parties in online transactions. Various types of e-business risks are:

1. **Transaction Risks :** Transaction risks can be of the following types :

   a) **Default on order giving/taking :** Seller denies that the order was placed or customer denies that he ever placed the order.

   b) **Default on delivery :** The intended delivery does not take place; goods are delivered at wrong address or goods other than ordered may be delivered.

   c) **Default on payment :** The customer claims that the payment was made and the seller does not receive the payment of the goods supplied.

   To avoid the above defaults, following measures can be used :

   i. The identity and location of the customer may be verified at the time of registration.

   ii. Seller can verify the 'cookies' to confirm whether the customer has correctly entered his details in the registration form. Cookies are like caller ID in Telephones that provide important information about customers to the telemarketers.

   iii. Customers must shop from well established shopping sites.

2. **Data Storage and Transmission Risk :** People may steal/distort the data for selfish motives/for fun. VIRUS (Vital Information Under Siege) and Hacking are the methods used for distorting data. Antivirus programmes should be installed from time to time. Cryptography is used to prevent interception of data in the course of transmission. Cryptography is the act of protecting information by transforming into an unreadable format called 'hyper text'. Only those who possess a secret key can decipher the message into 'plain text'.

3. **Risks to Intellectual Property and Privacy :** Anyone can copy the data available in the internet and supply it to others. **Junk materials formed** as a result of dumping advertisement materials can be a great problem.

INTEXT QUESTIONS 4.5

1. What is meant by e-Post?
2. Identify the linkage of the following terms in different e-Commerce applications.
   (a) Demat Account
   (b) Unified Message Service
   (c) Getting e-mail facility without direct access to Internet.
   (d) On-line booking of air ticket.

4.10 OUTSOURCING OF SERVICES

Another important trend in business, of late, has been 'outsourcing' of some of its activities i.e., use of outside sources to perform activities traditionally handled by internal staff and resources. For example, most companies have so far had their own staff for cleaning and security activities in their organisations. But, of late many companies have started entrusting these tasks to outside agencies on contractual basis. Infact, outsourcing is a management strategy by which an organisation contracts out its major non-core functions to specialised service providers with a view to benefit from their expertise, efficiency and cost effectiveness, and allow managers to concentrate on their core activities. The Information Technology (IT) is one area in which this approach is growing fast, and in recent years, outsourcing the operation of IT systems has been supplemented by a move to outsourcing the whole business processes such as payroll processing, cheque processing, etc. This is known as BPO (Business Process Outsourcing). It may be noted that Indian IT-BPO sector, both in domestic business and exports, has registered a growth of 28% in 2006-07 and revenues have exceeded $ 48 billion, nearly 10 fold increase over the aggregate revenue in 1998.

Need for BPO

1. Improvement in productivity.
2. Reduction in cost.
3. Opportunity to focus on core business.
4. Updation of technology.
5. Stimulates entrepreneurship, employment and export.

4.10.1 Features of Outsourcing of Services

The basic features of outsourcing of services are:

(a) It involves contracting out an activity to an outside specialised agency which takes complete responsibility to handle it effectively using its own manpower.

(b) Normally outsourcing is done in case of non-core activities such as housekeeping, security, etc. But, of late, it has been extended even to some of the core activities. For example, a school may engage a Computer Training Institute to handle computer education to its students or a bank may outsource its cheque processing.

(c) There are two main forms of outsourcing the business processes;

  (i) outsourcing to a third party, and

  (ii) outsourcing to its own subsidiary company specially formed to handle a specific activity.

4.10.2 Merits of Outsourcing of Services

(a) It provides an opportunity to the organisation to concentrate on areas in which it has core competency or strength. It keeps the organisation free from repetitive and mundane functions.

(b) It helps better utilisation of its resources as the management can focus its attention on selected activities and attain higher efficiency.

(c) It helps the organisation to get an expert and specialised service at competitive prices leading to provision of improved service and reduction in costs. The BPO organisations have considerable strength and adapt best practices to provide the service more efficiently.

(d) It enables expansion of business as resources saved from outsourcing can be used for expanding the production capacity and the product line and seek new markets.

(e) Apart from financial returns, it facilitates inter-organisational knowledge sharing and collaborative learning.

4.10.3 Limitations of Outsourcing of Services

(a) It may be opposed by labour unions who feel threatened by possible reduction in their strength and prospects.

(b) It reduces confidentiality as outsourcing involves sharing a lot of information with others. This implies a possibility of its communication to the competitors by such persons.

(c) Globalised outsourcing at times causes resentment in the manpower of the home countries who feel threatened by increased competition.

(d) The organisation hiring others may face the problem of loss of managerial control because it is more difficult to manage outside service providers than managing one's own employees. Not only that, it may also lead to decrease or total loss of in-house expertise and the organisation becomes partially or totally dependent on the service provider.

In view of the above limitations of outsourcing, it becomes necessary for the outsourcing company to take the necessary preventive steps, remain in constant touch with the service provider, and maintain control of the outsourced operations.

4.10.4 Knowledge Process Outsourcing (KPO)

KPO means outsourcing services that require expertise of a higher order. i.e. high end Knowledge Work is done by an outside organisation. KPO is mainly done to improve the efficiency and quality and to reduce costs of doing business. KPO requires professional with right skills, attitude and experience.

Distinction between BPO and KPO

BPO	*KPO*
1. Repeatable processes	1. Non repeatable process.
2. Quick learning is needed	2. Need regular learning process.
3. Large number of workers.	3. Smaller work force.
4. Comparatively less experts	4. Specialists/experts
5. Predetermined way to solve problem	5. No pre-determined way to solve problem.

INTEXT QUESTIONS 4.6

1. Define the term 'Outsourcing of services'.

2. Identify the merits and limitations of Outsourcing of Services.

   (a) It facilitates inter-organisational knowledge sharing and collaborative learning.

   (b) It reduces confidentiality of information.

   (c) It helps in concentrating on the core competency of the organisation.

   (d) The management finds it difficult to handle the outside staff.

(e) It provides expert and specialised service at competitive prices.

3. Multiple Choice Questions :

i. Name the act of protecting information by transforming into an unreadable format.

a) VIRUS b) Hacking

c) Cryptography d) None of the above

ii. In online buying the buyer drops the items selected in a __________.

a) Shopping cart b) Shopping box

c) Net card d) None of the above

iii. Plastic Card is the popular name for

a) Debit/Credit card b) Cheque

c) Digital Cash d) None of the above

WHAT YOU HAVE LEARNT

- To buy goods and services we normally visit the nearby market. But, virtual market mode facilitates the transactions of purchase and sale without actually visiting the real market. This has been made possible through introduction of information technology.
- The Internet is a worldwide system of computer network through which the users at any computer can access the information from any other computer. It helps the users to browse information on any topic, read the newspaper, exchange messages using e-mail, chatting, search the catalogues of goods and services and purchase items on-line and so on.
- e-Commerce refers to the process of conducting business with the help of electronic devices using the computer and interconnected telecommunication network. Here, offer for sale and its acceptance are made electronically through Internet. It is also known as 'on-line trading', 'on-line shopping' and 'e-shopping'. e-Commerce takes place between companies i.e., business to business (B2B), between companies and their customers (B2C), and customer to customer (C2C).
- e-Business covers not only the interaction with its customers and suppliers but also interactions and dealings among various departments and persons within the firm. e-Business includes not only B2B, B2C, and C2C but also Intra-B Commerce i.e., interaction and dealings among various departments and persons within the firm.

Notes

- Benefits of e-Commerce/e-Business:

  (a) Wider Accessibility
  (b) Improved Customers Service
  (c) Shortened Transaction Time
  (d) Cost Saving and Low Prices
  (e) Enlarge Business and Profits
  (f) Convenience to Customers

- Limitations of e-Commerce/e-Business:

  (a) It lacks personal touch with customers

  (b) The customer cannot actually see, feel or try on the goods he/she is buying.

  (c) The physical delivery of goods often takes long time.

  (d) Return of faulty goods bought on-line may often be more problematic and a time consuming exercise.

  (e) Shopping through Internet is not the same experience as a shopping expedition with family or friends.

  (f) Online transactions are prone to a number of risks that can result into financial, reputational or psychological losses to the parties involved in a transaction.

- **The Transaction Process**

  Search → Order → Payment → Delivery → After Sales Servic es

- **Precautions for Security**

  (a) Protected by Passwords

  (b) Off-line Authentication

  (c) Encryption, which refers to the conversion of data into a code so that it cannot be read by other users.

  (d) Use of digital signatures to authenticate the sender of the message

  (e) Copy of the transaction may be forwarded to a trusted third party.

- Applications of e-Commerce

  (a) e-Banking
  (b) e-ticketing
  (c) e-Advertising
  (d) e-Trading
  (e) e-Post

- Outsourcing is a management strategy by which an organisation contracts out its major non-core functions to specialised service providers with a view to benefit from their expertise, efficiency and cost effectiveness, and allow managers to concentrate on their core activities.

- E-business requires a website, technically qualified workforce, computer and effective telecommunication system.
- Before performing online buying, customer must find the seller, select the product and place an order.
- Payment in online shopping can be through COD, Cheque, Net banking transfer, Credit/debit card, Digital Cash etc.
- Scope for BPO are productivity improvement, cost reduction, focus on core business technology upgradation and stimulation of entrepreneurship.
- KPO means outsourcing services that require expertise of a higher order.

KEY TERMS

ATM	e-Business	Internet
Business Process Outsourcing	e-Commerce	Internet Banking
Credit Card	e-Post	Mobile Banking
Debit Card	e-Ticketing	Telebanking
e-Banking	e-Trading	

TERMINAL EXERCISE

Very Short Answer Type Questions

1. Define the term 'e-commerce'.
2. State any two precautions one should take while making on-line transactions.
3. Mention any two advantages of outsourcing of services.
4. What is meant by 'Internet banking'?
5. Give the meaning of 'B2C e-commerce'.
6. Give the full form of the BPO and KPO.
7. Name the electronic currency that exists in cyberspace.

Short Answer Type Questions

8. State any four uses of Internet in our daily life.
9. Distinguish between 'e-Business' and 'e-Commerce'.

Notes

10. Mention any four limitations of 'e-Commerce'.
11. Distinguish between 'Debit Card' and 'Credit Card'.
12. Explain the usefulness of 'e-Post' facility for the general public.
13. State any two requirements for successful implementation of e-business.
14. What is meant by Knowledge Process Outsourcing?

Long Answer Type Questions

15. Explain the merits of 'e-Commerce'.
16. Describe the transaction process of 'e-Commerce'.
17. Explain any four new trends of banking services under the e-Banking mode.
18. What is meant by outsourcing of services? Explain its features.
19. State the meaning of 'e-Banking'. Explain any two modes of e-Banking.
20. Distinguish between BPO and KPO.
21. How can security of e-business transactions be ensured?
22. Explain the step involved in the payment mechanism of online transactions?
23. **You are interested to give a new mobile phone to your mother as a gift on mother's day. One of your friend told you that you can get it quite cheaper through online shopping, for which you have no experience. But you decide to try at least once. Explain the steps you will follow to get the mobile phone for your mother through online shopping.**
24. **Your father is a businessman having a business of digital watches. He heard a lot about e-business from his friends, newspaers & magzaines. Now he is equally interested in entering in the field of business as he want to enter into new markets which were far off from his reach. As a student of class XII, he discussed the matter with you. Explain him the various resources required for the successful implementation of e-business.**

ANSWERS TO INTEXT QUESTIONS

4.1 1. Internet is a worldwide system of computer network through which the users at any computer can access the information from other computers.

2. www: World Wide Web — B2B: Business to Business

   B2C: Business to Customer — C2C: Consumer to Consumer

4.2 1. Intra-B Commerce refers to interaction and dealings among various departments and persons within the firm with the help of computer and interconnected telecommunication network.

2. (a) Lack of adequate infrastructure
(b) Delivery and payment related problems
(c) Absence of cyber laws

3. Merits: (b), (c), (d)   Limitations: (a), (e)

4.3 1. (a) Credit card   (b) Debit card   (c) Store's value card   (d) Cheque
2. (d), (a), (c), (b), (e)

4.4 1. (a) withdrawals and deposits of money   (b) Balance inquiry
(c) Mini-statement of transactions

2. (a) Credit card   (b) ATM   (c) Telebanking   (d) Internet banking

4.5 1. e-post is a service offered by post office through which printed or hand written messages are transmitted as e-mail on internet.

2. (a) e-Trading at stock exchanges
(b) Computerisation of mail transmission and Processing
(c) e-Post   (d) e-Ticketing

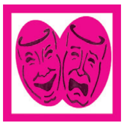
4.6 1. Outsourcing of services is a management strategy by which an organization contracts out its major non-core functions to outside specialised service providers.

2. Merits: (a), (c), (e)   Limitations: (b), (d)

3. (i) c   (ii) a   (iii) a

DO AND LEARN

You are required to visit the nearby post offices and banks and find out the various services that are being rendered electronically or through the use of computers. Make a list of those services and their features.



ROLE PLAY

1. Mr. A. Reddy is a 70 year old man and was hurriedly going through the daily chores and getting ready. His grandson Satish, who works as an officer in SBI, was silently observing his activities.

A. Reddy : Satish, please find out if my breakfast is ready?

Notes

Satish : Okay, grandpa. But, where are you going so early? I find you in a great hurry!

A. Reddy : I have a lot of work to do today that may take the whole day. First, I have to book the train ticket for Mumbai, as I have planned to visit my brother. Thereafter I have to go to the bank to withdraw Rs.10, 000. Then, I have to go to the Post Office to send money order to my sister who is at Vellore. You see, I have to perform to so many activities today.

Satish : Oh! now I understand why you are so worried.

A. Reddy : You know that there are long queues for tickets at rail booking counters. It may take atleast two hours. There will be little time left for other things to do.

Satish : Grandpa! You are still living in your olden days. Things have drastically changed now. Haven't you heard about e-Ticketing and e-Banking?

A. Reddy : What? e-Banking and e-Ticketing?

Satish : Yes, grandpa. These are new modes of business transactions. You don't have to sweat in the long queue for tickets now and run the risk of carrying money.

(Satish explains each of these modes to his grandfather. Assume a role for you-self and the other for your friend and carry on the conversation between Satish and his grandfather).

2. Sonam a girl of 15 years of age once got an opportunity to visit the branch of a Bank along with her mother. Due to failure of server, her mother could not perform the transactions she wanted to perform. Now Sanam is curious to know the role of server in Banking activities. Her mother took her to the Bank manager.

Sonam : Good morning Sir, today I came to Bank with my mother for some work, but we came to know that server is down.

Manager : Good morning, Yes, today the server is not working for which I am extremely sorry for the inconvinence caused to you.

Sonam : No need to feel sorry sir, I just want to be know something more about the role of internet in Banking services.

Manager : Sure.

Please continue the discussion of Sonam & Bank Manager about the e-banking & various services provided by bank to general public through internet.

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5

FORMS OF BUSINESS ORGANISATION

You have studied in the first lesson about the business, its significance and the classification of business activities. You are also aware that these activities are carried out by individuals in an organised form of a business house having different patterns of ownership and management. A single individual may own the business or a number of individuals may come together to own the business jointly. So, based on ownership, we have different forms of business organisation like a proprietary concern, a partnership firm or a company. In this lesson, you will learn about the various forms of business organisation (excluding a joint stock company), their characteristics, merits and limitations, suitability and the steps involved in their formation.

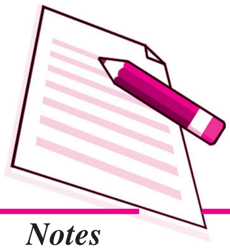
OBJECTIVES

After studying this lesson, you will be able to:

- explain the concept of business organisation;
- state the meaning and characteristics of Sole Proprietorship, Partnership, Joint Hindu Family Business and Cooperative Societies.
- identify the merits and limitations of these forms of business organisation; and
- describe the suitability of these forms of business organisation.

5.1 BUSINESS ORGANISATION

You have already learnt about the meaning of business and the various types of business activities like industry, trade, transport, banking, insurance etc. If you observe these business activities carefully, you will realise that whatever business activity one may take up, he has to bring together various resources like men, money, materials, machines, technology, etc. to carryout that activity successfully. Not only that these resources are to be put into action in a systematic manner to achieve the objectives of business.



Let us take the example of a rice mill. First, the owner will have to acquire a land, construct a building, buy machines and install them, employ labour to work, buy paddy and then process the paddy to produce rice that will be sold to the customers. Thus, to produce rice from paddy you need to assemble resources like land, building, machinery, labour etc., and put these resources together in action in a systematic way. Then only it becomes possible to produce rice and sell it to the customers, and earn profit.

Thus, to carry out any business and achieve its objective of earning profit it is required to bring together all the resources and put them into action in a systematic way, and coordinate and control these activities properly. This arrangement is known as business organisation.

5.2 FORMS OF BUSINESS ORGANISATION

Have you ever thought who brings the required capital, takes the responsibility of arranging other resources, puts them into action, and coordinates and controls the activities to earn the desired profits? If you look around, you will find that a small grocery shop is owned and run by a single individual who performs all these activities. But, in big businesses, it may not be possible for a single person to perform all these activities. So in such cases two or more persons join hands to finance and manage the business properly and share its profit as per their agreement. Thus, business organisations may be owned and managed by a single individual or group of individuals who may form a partnership firm or a joint stock company. Such arrangement of ownership and management is termed as a form of business organisation. A business organisation usually takes the following forms in India:

(1) Sole proprietorship

(2) Partnership

(3) Joint Hindu Family

(4) Cooperative Society

(5) Joint Stock Company

Let us now learn in detail the exact nature of these forms of business organisation, excluding Joint Stock Company which will be taken up in the next lesson.

5.3 SOLE PROPRIETORSHIP

Gopal runs a grocery shop in the local market. He buys goods from the wholesale market and sells it to the customers as per their requirement. By doing so he earns some profit. He had started his business two years ago by investing Rs. 1 lakh, which he had borrowed from his friend. Today, he is running his business successfully, earning a good profit, and has been able to pay back the borrowed money. He has also employed two persons to help him in the shop. Gopal says, he is the owner of a sole proprietor concern.

Do you agree?

Before giving answer to this question, let us first know the exact nature of 'sole proprietorship'.

The term 'sole' means single and 'proprietorship' means 'ownership'. So, only one person is the owner of the business organisation. This means, that a form of business organisation in which a single individual owns and manages the business, takes the profits and bears the losses, is known as sole proprietorship form of business organisation.

Gopal is doing exactly the same thing. So, you can say that Gopal is running a sole proprietorship business, and is known as a sole proprietor or a sole trader.

You must have seen many more such business organisations in and around your locality. Could you now make a list of such concerns engaged in different types of businesses?

1. Supreme Drycleaners
2. ________________________________
3. ________________________________
4. ________________________________
5. ________________________________

Definition of Sole Proprietorship

J.L. Hanson: "A type of business unit where one person is solely responsible for providing the capital and bearing the risk of the enterprise, and for the management of the business."

Thus, 'Sole Proprietorship' from of business organisation refers to a business enterprise exclusively owned, managed and controlled by a single person with all authority, responsibility and risk.

Now you can workout certain characteristics of sole proprietorship form of business organisation.

5.3.1 Characteristics of Sole Proprietorship Form of Business Organisation

(a) **Single Ownership :** The sole proprietorship form of business organisation has a single owner who himself/herself starts the business by bringing together all the resources.

(b) **No Separation of Ownership and Management :** The owner himself/herself manages the business as per his/her own skill and intelligence. There is no separation of ownership and management as the case with company form of business organisation.

Notes

(c) **Less Legal Formalities :** The formation and operation of a sole proprietorship form of business organisation does not involve any legal formalities. Thus, its formation is quite easy and simple.

(d) **No Separate Entity :** The business unit does not have an entity separate from the owner. The businessman and the business enterprise are one and the same, and the businessman is responsible for everything that happens in his business unit.

(e) **No Sharing of Profit and Loss :** The sole proprietor enjoys the profits alone. At the same time, the entire loss is also borne by him. No other person is there to share the profits and losses of the business. He alone bears the risks and reaps the profits.

(f) **Unlimited Liability :** The liability of the sole proprietor is unlimited. In case of loss, if his business assets are not enough to pay the business liabilities, his personal property can also be utilised to pay off the liabilities of the business.

(g) **One-man Control :** The controlling power of the sole proprietorship business always remains with the owner. He/she runs the business as per his/her own will.

Gopal is happy in running his business in sole proprietorship form because he enjoys many benefits in doing this business. At the same time, he also comes across many difficulties. Would you like to know the merits and limitations of this form of business organisation? Let us discuss.

5.3.2 Merits of Sole Proprietorship Form of Business Organisation

(a) **Easy to Form and Wind Up:** It is very easy and simple to form a sole proprietorship form of business organisation. No legal formalities are required to be observed. Similarly, the business can be wound up any time if the proprietor so decides.

(b) **Quick Decision and Prompt Action:** As stated earlier, nobody interferes in the affairs of the sole proprietary organisation. So he/she can take quick decisions on the various issues relating to business and accordingly prompt action can be taken.

(c) **Direct Motivation:** In sole proprietorship form of business organisations. the entire profit of the business goes to the owner. This motivates the proprietor to work hard and run the business efficiently.

(d) **Flexibility in Operation:** It is very easy to effect changes as per the requirements of the business. The expansion or curtailment of business activities does not require many formalities as in the case of other forms of business organisation.

(e) **Maintenance of Business Secrets:** The business secrets are known only to the proprietor. He is not required to disclose any information to others unless and until he himself so decides. He is also not bound to publish his business accounts.

(f) **Personal Touch:** Since the proprietor himself handles everything relating to business, it is easy to maintain a good personal contact with the customers and employees. By knowing the likes, dislikes and tastes of the customers, the proprietor can adjust his operations accordingly. Similarly, as the employees are few and work directly under the proprietor, it helps in maintaining a harmonious relationship with them, and run the business smoothly.

After knowing the various merits of sole proprietorship form of business organisation let us discuss its limitations.

5.3.3 Limitations of Sole Proprietorship Form of Business Organisation

(a) **Limited Resources :** The resources of a sole proprietor are always limited. Being the single owner it is not always possible to arrange sufficient funds from his own sources. Again borrowing funds from friends and relatives or from banks has its own implications. So, the proprietor has a limited capacity to raise funds for his business.

(b) **Lack of Continuity :** The continuity of the business is linked with the life of the proprietor. Illness, death or insolvency of the proprietor can lead to closure of the business. Thus, the continuity of business is uncertain.

(c) **Unlimited Liability :** You have already learnt that there is no separate entity of the business from its owner. In the eyes of law the proprietor and the business are one and the same. So personal properties of the owner can also be used to meet the business obligations and debts.

(d) **Not Suitable for Large Scale Operations :** Since the resources and the managerial ability is limited, sole proprietorship form of business organisation is not suitable for large-scale business.

(e) **Limited Managerial Expertise :** A sole proprietorship from of business organisation always suffers from lack of managerial expertise. A single person may not be an expert in all fields like, purchasing, selling, financing etc. Again, because of limited financial resources, and the size of the business it is also not possible to engage the professional managers in sole proprietorship form of business organisations.

Notes

Now you must have a clear idea about Gopal's business and its merits and limitations. Take the example of any other sole proprietorship form of business organisation of your locality analyse its activities and try to find out whether the points discussed above are applicable to it or not. Application of book knowledge in real life situations will definitely help you to comprehend and remember the facts about sole proprietorship form of business organisation in a better way.

5.3.4 Suitability of Sole Proprietorship form of Business Organisation

You learnt about the meaning, characteristics, merits and limitations of sole proprietorship form of business organisations. After such a detailed study, it should now be easier for you to identify areas in which sole proprietorship form of business organisation is most suitable. To assist you in such exercise, it can be stated that the sole proprietorship is suitable where the market is limited, localised and the customers give importance to personal attention. It is also considered suitable where the capital requirement is small and risk involved is limited. It is also considered suitable for the production of goods which involve manual skill e.g., handicrafts, filigree work, jewelry, tailoring, haircutting etc.

Move around your locality and make a list of different types of business being run by sole proprietors and then categorise them under the above points.

INTEXT QUESTIONS 5.1

1. Define 'Sole Proprietorship' in your own words.
2. Below are given the merits and limitations of sole proprietorship form of business organisation. Write 'M' against Merits and 'L' against Limitations in the space provided against each.

   (a) A sole proprietorship business is easy to form.

   (b) A sole proprietor is personally liable for all the liabilities of the business.

   (c) A sole proprietor has a limited capacity to raise funds for his business.

   (d) A sole proprietor can maintain secrecy about the affairs of his business.

   (e) A sole proprietor maintains good personal contact with the customers.

Notes

3. Match the following with reference to sole proprietorship business.

Column - A	Column - B
(a) Liability	(i) Easy
(b) Formation	(ii) minimum
(c) Resource	(iii) prompt
(d) Decision making	(iv) Unlimited
(e) Legal formalities	(v) Limited

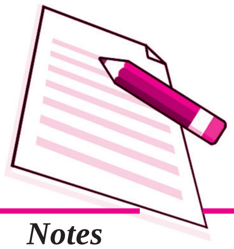
5.4 PARTNERSHIP

A textile factory is going to be started in the nearby area where Gopal is carrying on his business. As a businessman, he is now in a jubilant mood. He is thinking that once the textile factory is set up, he will get more customers; the sales will increase and he will earn more profit. But, for all these, he will have to expand his business, and for this he needs more money.

The major problem is how to arrange the additional funds. He has the option of getting loans from the banks. But the fear of loss comes to his mind again and again. He does not want to take that risk. Another option is that he may join hands with some other person. By doing so, more resources can be raised, work can be shared, and business can be run in a better way. The risk of loss will also be shared. But this involves a new form of business organisation known as ***Partnership*** *organisation. Gopal has to gain clarity on the exact nature of this form of business organisation, its pros and cons before he goes in for it.*

'Partnership' is an association of two or more persons who pool their financial and managerial resources and agree to carry on a business, and share its profit. The persons who form a partnership are individually known as partners and collectively a **firm or partnership firm**.

Let's assume that Gopal joins hand with Rahim to start a big grocery shop. Here both Gopal and Rahim are called partners who are running the partnership firm jointly. Both of them will pool their resources and carry on business by applying their expertise. They will share the profits and losses in the agreed ratio. In fact, for all terms and conditions of their working, they have to sit together to decide about all aspects. There must be an agreement between them. The agreement may be in oral, written or implied. When the agreement is in writing it is termed as partnership deed. However, in the absence of an agreement, the provisions of the Indian Partnership Act 1932 shall apply.



Notes

As per Indian Companies Act 1913 there can be 50 partners in partnership firm.

Partnership form of business organisation in India is governed by the Indian Partnership Act, 1932 which defines partnership as "the relation between persons who have agreed to share the profits of the business carried on by all or any of them acting for all".

5.4.1 Characteristics of Partnership form of Business Organisation

Based on the definition of partnership as given above, the various characteristics of partnership form of business organisation, can be summarised as follows:

(a) **Two or More Persons :** To form a partnership firm atleast two persons are required. The maximum limit on the number of persons is ten for banking business and 20 for other businesses. If the number exceeds the above limit, the partnership becomes illegal and the relationship among them cannot be called partnership.

(b) **Contractual Relationship :** Partnership is created by an agreement among the persons who have agreed to join hands. Such persons must be competent to contract. Thus, minors, lunatics and insolvent persons are not eligible to become the partners. However, a minor can be admitted to the benefits of partnership firm i.e., he can have share in the profits without any obligation for losses.

(c) **Sharing Profits and Business :** There must be an agreement among the partners to share the profits and losses of the business of the partnership firm. If two or more persons share the income of jointly owned property, it is not regarded as partnership.

(d) **Existence of Lawful Business :** The business of which the persons have agreed to share the profit must be lawful. Any agreement to indulge in smuggling, black marketing etc. cannot be called partnership business in the eyes of law.

(e) **Principal Agent Relationship :** There must be an agency relationship between the partners. Every partner is the principal as well as the agent of the firm. When a partner deals with other parties he/she acts as an agent of other partners, and at the same time the other partners become the principal.

(f) **Unlimited Liability :** The partners of the firm have unlimited liability. They are jointly as well as individually liable for the debts and obligations of the firms. If the assets of the firm are insufficient to meet the firm's liabilities, the personal properties of the partners can also be utilised for this purpose. However, the liability of a minor partner is limited to the extent of his share in the profits.

(g) **Voluntary Registration :** The registration of partnership firm is not compulsory. But an unregistered firm suffers from some limitations which makes it virtually compulsory to be registered. Following are the limitations of an unregistered firm.

(i) The firm cannot sue outsiders, although the outsiders can sue it.

(ii) In case of any dispute among the partners, it is not possible to settle the dispute through court of law.

(iii) The firm cannot claim adjustments for amount payable to, or receivable from, any other parties.

Notes

5.4.2 Merits of Partnership Form of Business Organisation

(a) **Easy to Form :** A partnership can be formed easily without many legal formalities. Since it is not compulsory to get the firm registered, a simple agreement, either in oral, writing or implied is sufficient to create a partnership firm.

(b) **Availability of Larger Resources :** Since two or more partners join hands to start partnership firm it may be possible to pool more resources as compared to sole proprietorship form of business organisation.

(c) **Better Decisions :** In partnership firm each partner has a right to take part in the management of the business. All major decisions are taken in consultation with and with the consent of all partners. Thus, collective wisdom prevails and there is less scope for reckless and hasty decisions.

(d) **Flexibility :** The partnership firm is a flexible organisation. At any time the partners can decide to change the size or nature of business or area of its operation after taking the necessary consent of all the partners.

(e) **Sharing of Risks :** The losses of the firm are shared by all the partners equally or as per the agreed ratio.

(f) **Keen Interest :** Since partners share the profit and bear the losses, they take keen interest in the affairs of the business.

(g) **Benefits of Specialisation :** All partners actively participate in the business as per their specialisation and knowledge. In a partnership firm providing legal consultancy to people, one partner may deal with civil cases, one in criminal cases, another in labour cases and so on as per their area of specialisation. Similarly two or more doctors of different specialisation may start a clinic in partnership.

(h) **Protection of Interest :** In partnership form of business organisation, the rights of each partner and his/her interests are fully protected. If a partner is dissatisfied with any decision, he can ask for dissolution of the firm or can withdraw from the partnership.

(i) **Secrecy :** Business secrets of the firm are only known to the partners. It is not required to disclose any information to the outsiders. It is also not mandatory to publish the annual accounts of the firm.

Notes

Having learnt about the nature and merits of the partnership form of business organisation, now Gopal has decided to expand his business by starting a partnership form of business. One day, in a happy mood, he met Rahim (who also runs a grocery shop in the same locality) and explained to him about the concept, characteristics and merits of partnership form of business organisation. Rahim heard Gopal very carefully and asked Gopal about the limitations (if any) of this form of business organisation. Gopal had no idea about any limitations. Let him now have an idea about the limitations of partnership form of business organisation.

5.4.3 Limitations of Partnership Form of Business Organisation

A partnership firm also suffers from certain limitations. These are as follows:

(a) **Unlimited Liability :** The most important drawback of partnership firm is that the liability of the partners is unlimited i.e., the partners are personally liable for the debt and obligations of the firm. In other words, their personal property can also be utilised for payment of firm's liabilities.

(b) **Instability :** Every partnership firm has uncertain life. The death, insolvency, incapacity or the retirement of any partner brings the firm to an end. Not only that any dissenting partner can give notice at any time for dissolution of partnership.

(c) **Limited Capital :** Since the total number of partners cannot exceed 20, the capacity to raise funds remains limited as compared to a joint stock company where there is no limit on the number of share holders.

(d) **Non-transferability of share :** The share of interest of any partner cannot be transferred to other partners or to the outsiders. So it creates inconvenience for the partner who wants to transfer his share to others fully or partly. The only alternative is dissolution of the firm.

(e) **Possibility of Conflicts :** You know that in partnership firm every partner has an equal right to participate in the management. Also every partner can place his or her opinion or viewpoint before the management regarding any matter at any time. Because of this, sometimes there is friction and quarrel among the partners. Difference of opinion may give rise to quarrels and lead to dissolution of the firm.

5.4.4 Types of Partners and Partnership

Types of Partners

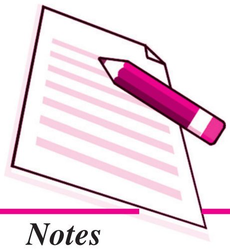
You have learnt that normally every partner in a firm contributes to its capital, participates in the day-to-day management of firm's activities, and shares its profits and losses in the agreed ratio. In other words all partners are supposed to be active partners. However, in certain cases there are partners who play a limited role. They may contribute capital and such partners cannot be termed as active partners. Similarly, some persons may simply lend their name to the firm and make no contribution to capital of the firm. Such persons are partners only in name. Thus, depending upon the extent of participation and the sharing of profits, liability etc., partners can be classified into various categories. These are summarised as under.

(A) Based on the extent of participation in the day-to-day management of the firm partners can be classified as 'Active Partners' and 'Sleeping Partners'. The partners who actively participate in the day-to-day operations of the business are known as active partners or working partners. Those partners who do not participate in the day-to-day activities of the business are known as sleeping or dormant partners. Such partners simply contribute capital and share the profits and losses.

(B) Based on sharing of profits, the partners may be classified as 'Nominal Partners' and 'Partners in Profits'. Nominal partners allow the firm to use their name as partner. They neither invest any capital nor participate in the day-to-day operations. They are not entitled to share the profits of the firm. However, they are liable to third parties for all the acts of the firm. A person who shares the profits of the business without being liable for the losses is known as partner in profits. This is applicable only to the minors who are admitted to the benefits of the firm and their liability is limited to their capital contribution.

(C) Based on Liability, the partners can be classified as 'Limited Partners' and 'General Partners'. The liability of limited partners is limited to the extent of their capital contribution. This type of partners is found in Limited Partnership firms in some European countries and USA. The partners having unlimited liability are called as general partners or Partners with unlimited liability. It may be noted that every partner who is not a limited partner is treated as a general partner.

(D) Based on the behaviour and conduct exhibited, there are two more types of partners besides the ones discussed above. These are (a) Partner by Estoppel; and (b) Partner by Holding out. A person who behaves in the public in such a way as to give an impression that he/she is a partner of the firm, is called 'partner by estoppel'. Such partners are not entitled to share the profits of the firm, but are fully liable if some body suffers because of his/her false representation. Similarly, if a partner or partnership firm declares that a particular person is a partner of their firm, and such a person does not disclaim it, then he/she is known as 'Partner by Holding out'. Such partners are not entitled to profits but are fully liable as regards the firm's debts.



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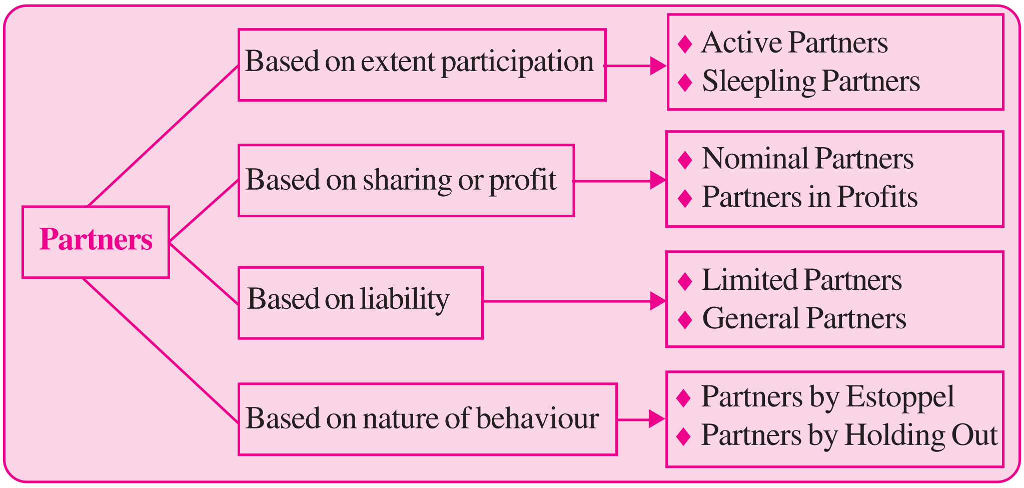


Types of Partnership

Partnership can be categorised as under :

1. **General and Limited Partnership :** In the general partnership, the liability of the partners is unlimited, whereas limited partnership has two types of partners : General Partner and Special Partner. Liability of general partner is unlimited whereas liability of special partner is limited. There should be at least one general partner in the limited partnership.

2. **Partnership at Will and Particular Partnership :** Partnership at will can be formed to run the business for an indefinite period, while particular partnership can be formed for some specific purpose and it ends with the attainment of pre-determined specific purpose.

3. **Legal and Illegal Partnership :** Although it is not essential to get the partnership registered under Indian Partnership Act, 1932 in order to bring it into existence, yet the partnership organisations have to work in accordance with the provisions of the Act. Those partnerships which work according to the provisions of the Act are considered as legal and are called legal partnerships.

   On the contrary, partnership becomes illegal or non-statutory in the following conditions:

   i. If the purpose of the establishment of partnership is illegal.

   ii. If the business of partnership is against public policy.

   iii. If the number of partners reduces to one or exceeds the maximum limit.

   iv. If there is any partner from an enemy country.

Notes

One of Gopal's friends Rahul comes to his shop and sits there for hours together. In Gopal's absence, he attends to the customers and deals with his suppliers. Under the impression that Rahul is a partner (although he is not), a supplier finalised a deal which Gopal does not accept. In the process, the supplier suffers some loss. Can he claim the compensation from Rahul? What type of partner Rahul is?

5.4.5 Suitability of Partnership form of Business Organisation

We have already learnt that persons having different ability, skill or expertise can join hands to form a partnership firm to carry on the business. Business activities like construction, providing legal services, medical services etc. can be successfully run under this form of business organisation. It is also considered suitable where capital requirement is of a medium size. Thus, business like a wholesale trade, professional services, mercantile houses and small manufacturing units can be successfully run by partnership firms.

5.4.6 Partnership Deed

There must be an agreement among the partners to carry on the business and share the profits and losses. This agreement must preferably be in writing and duly signed the all the partners. The agreement, i.e., the partnership deed must contain the following:

(i) Name of the firm

(ii) Nature of the business

(iii) Names and addresses of partners

(iv) Location of business

(v) Duration of partnership, if decided

(vi) Amount of capital to be contributed by each partner

(vii) Profit and loss sharing ratio

(viii) Duties, powers and obligations of partners.

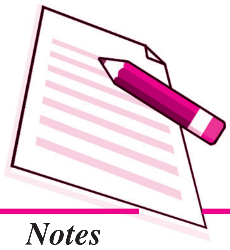
(ix) Salaries and withdrawals of the partners

(x) Preparation of accounts and their auditing.

(xi) Procedure for dissolution of the firm etc.

(xii) Procedure for settlement of disputes

The partners should get their firm registered with the Registrar of Firms of the concerned state. Although registration is not compulsory, but to avoid the consequences of non-



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registration, it is advisable to get it registered when it is setup or at any time during its existence. The procedure for registration of a firm is as follows.

(i) The firm will have to apply to the Registrar of Firms of the concerned state in the prescribed form.

(ii) The duly filled in form must be signed by all the partners.

(iii) The filled in form along with prescribed registration fee must be deposited in the office of the Registrar of Firms.

(iv) The Registrar will scrutinise the application, and if he is satisfied that all formalities relating to registration have been duly complied with, he will put the name of the firm in his register and issue the Certificate of Registration.

Gopal is now running the partnership firm along with Rahim as a partner. They are earning good profit and managing their business smoothly.

Gopal's father also runs a wholesale business in the same locality. That business was earlier being managed by Gopal's grand father. One-day Gopal's father revealed that Gopal and his younger brother and sister have an equal share in his wholesale business. It is a family business and Gopal can continue his own partnership business without losing his position in this family business. Gopal was confused. His father explained to him that under Hindu Law it is a Joint Hindu Family business. Let us know in detail about Joint Hindu Family form of business organisation.

INTEXT QUESTIONS 5.2

1. State the position of minors in relation to a partnership firm.

2. Following are the statements related to partnership form of business organisation. Rewrite the statement in correct form if found wrong.

   (a) Maximum 20 partners can join in a partnership firm running banking business.

   (b) Partnership Deed may be either oral or in writing.

   (c) There is an employer-employee relationship among the partners.

   (d) In a partnership firm Hari and Madhu contributed Rs. 10,000 each Madhu's liability would be limited to Rs. 10,000 in case of losses in firm's business.

   (e) A person acquired interest in a partnership firm by virtue of his relationship with the existing partners.

3. Identify the type of partners in the following situation:

   (a) The liability of Sridhar, a 25 years old partner is limited to the extent of his capital contribution.

   (b) Madan has neither contributed any capital nor shares the profits of the firm though he is treated as a partner.

   (c) Sunita has been admitted to the benefits of the firm at the age of 15.

   (d) Sudhir had contributed to capital and shares the profit and loss of the firm. But he does not take part in the day-to-day activities.

   (e) A firm declares that Sachin is a partner of their firm. Knowing the declaration Sachin did not disclaim it.

5.5 JOINT HINDU FAMILY FORM OF BUSINESS ORGANISATION

After knowing about sole proprietorship and partnership forms of business organisation let us now discuss about a unique form of business organisation that prevails only in India and that too among the Hindus. The Joint Hindu Family (JHF) business is a form of business organisation run by Hindu Undivided Family (HUF), where the family members of three successive generations own the business jointly. The head of the family known as Karta manages the business. The other members are called co-parceners and all of them have equal ownership right over the properties of the business.

The membership of the JHF is acquired by virtue of birth in the same family. There is no restriction for minors to become the members of the business. As per Dayabhaga system of Hindu Law, both male and female members are the joint owners. But Mitakashara system of Hindu Law says only male members of the family can become the coparceners. While the Dayabhaga system is applicable to the state of West Bengal, Mitakshara system of Hindu Law is applicable to the rest of the country.

5.5.1 Characteristics of JHF form of Business Organisation

From the above discussion, it must have been clear to you that the Joint Hindu family business has certain special characteristics which are as follows:

(a) **Formation :** In JHF business there must be at least two members in the family, and family should have some ancestral property. It is not created by an agreement but by operation of law.

(b) **Legal Status :** The JHF business is a jointly owned business. It is governed by the Hindu Succession Act 1956.

(c) **Membership :** In JHF business outsiders are not allowed to become the coparcener. Only the members of undivided family acquire co-parcenership rights by birth..

Notes

(d) **Profit Sharing :** All coparceners have equal share in the profits of the business.

(e) **Management :** The business is managed by the senior most member of the family known as Karta. Other members do not have the right to participate in the management. The Karta has the authority to manage the business as per his own will and his ways of managing cannot be questioned. If the coparceners are not satisfied, the only remedy is to get the HUF status of the family dissolved by mutual agreement.

(f) **Liability :** The liability of coparceners is limited to the extent of their share in the business. But the Karta has an unlimited liability. His personal property can also be utilised to meet the business liability.

(g) **Continuity :** Death of any coparceners does not affect the continuity of business. Even on the death of the Karta, it continues to exist as the eldest of the coparceners takes position of Karta. However, JHF business can be dissolved either through mutual agreement or by partition suit in the court.

5.5.2 Merits of JHF form of Business Organisation

Since Joint Hindu Family business has certain peculiar features as discussed above, it has the following merits.

(a) **Assured Shares in Profits :** Every coparcener is assured of an equal share in the profits irrespective of his participation in the running of the business. This safeguards the interest of minor, sick, physically and mentally challenged coparceners.

(b) **Quick Decision :** The Karta enjoys full freedom in managing the business. It enables him to take quick decisions without any interference.

(c) **Sharing of Knowledge and Experience :** A JHF business provides opportunity for the young members of the family to get the benefits of knowledge and experience of the elder members. It also helps in inculcating virtues like discipline, self-sacrifice, tolerance etc.

(d) **Limited Liability of Members :** The liability of the coparceners except the Karta is limited to the extent of his share in the business. This enables the members to run the business freely just by following the instructions or direction of the Karta.

(e) **Unlimited Liability of the Karta :** Because of the unlimited liability of the Karta, his personal properties are at stake in case the business fails to pay the creditors. This clause of JHF business makes the Karta has to manage business most carefully and efficiently.

(f) **Continued Existence :** The death or insolvency of any member does not affect the continuity of the business. So it can continue for a long period of time.

(g) **Tax Benefits :** HUF is regarded as an independent assessee for tax purposes. The share of coparceners is not to be included in their individual income for tax purposes.

Notes

After knowing the merits let us see the limitations of Joint Hindu Family form of business organisation.

5.5.3 Limitation of JHF form of Business Organisation

(a) **Limited Resources :** JHF business has generally limited financial and managerial resources. Therefore, it is not considered suitable for large business.

(b) **Lack of Motivation :** The coparceners get equal share in the profits of the business irrespective of their participation. So generally they are not motivated to put in their best.

(c) **Scope for Misuse of Power :** Since the Karta has absolute freedom to manage the business, there is scope for him to misuse it for his personal gains. Moreover, he may have his own limitations.

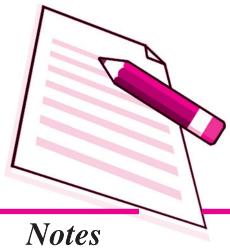
(d) **Instability :** The continuity of JHF business is always under threat. A small rift within the family may lead to seeking partition.

5.5.4 Suitability of JHF form of Business Organisation

The Joint Hindu Family form of business organisation is suitable where the family inherits a running business and the members of the family want to continue that business jointly as a family business. Even otherwise, this form of business organisation is considered suitable for a business that requires limited financial and managerial resources and having a very limited area of operation. It is found that JHF are usually engaged in trading business, indigenous banking, small industry, and crafts etc.

5.5.5 Formation of JHF form of Business Organisation

A Joint Hindu Family business is formed as per the provision of Hindu law. It comes into existence on the death of the person who established the business. His successor automatically become the coparceners if they decide to continue it as a joint family business. The children become its members by birth. The senior most member of the family will become the Karta of the business. No legal formalities are required for its establishment. But it has to be registered with the Income tax department to avail the tax concessions involved.



Notes

INTEXT QUESTIONS 5.3

1. Why should the liability of Karta be unlimited?
2. State whether it is a merit or a limitation of Joint Hindu Family business. Write 'M' for merit and 'L' for limitation in the box given against each statement.
   (a) Young family member gains knowledge and experiences from other members.
   (b) The death or insolvency of member does not affect the continuity of the business.
   (c) The coparceners are not motivated to put their best efforts.
   (d) The members get equal share in the profits irrespective of their participation.
   (e) The Karta takes quick decision without any interference.
3. Distinguish between partnership and Joint Hindu Family business on the basis of membership.

5.6 COOPERATIVE SOCIETY

You have learnt about Sole Proprietorship and Partnership as different forms of business organisation. You must have noticed that while there are many differences among them in respect of their formation, operation, capital contribution and liabilities, there is one similarity that both are engaged in business to earn profit. However, there are certain organisations which undertake business activities with the prime objective of providing service to the members. Although they also earn some amount of profit, but their main intention is to look after some common interest of its members. They pool available resources from the members, utilise the same in the best possible manner and share the benefits. These organisations are known as Cooperative Societies. Let us learn in detail about this form of business organisation.

The term cooperation is derived from the Latin word 'co-operari', where the word 'Co' means 'with' and 'operari' mean 'to work'. Thus, the term cooperation means working together. So those who want to work together with some common economic objectives can form a society, which is termed as cooperative society.

It is a voluntary association of persons who work together to promote their economic interest. It works on the principle of self-help and mutual help. The primary objective is to provide support to the members. People come forward as a group, pool their individual resources, utilise them in the best possible manner and derive some common benefits out of it.

> *The Section 4 of the Indian Cooperative Societies Act 1912 defines Cooperative Society as "a society, which has its objectives for the promotion of economic interests of its members in accordance with cooperative principles."*

5.6.1 Characteristics of Cooperative Society

Based on the above definition we can identify the following characteristics of cooperative society form of business organisation:

(a) Voluntary Association : Members join the cooperative society voluntarily i.e., by their own choice. Persons having common economic objective can join the society as and when they like, continue as long as they like and leave the society and when they want.

(b) Open Membership : The membership is open to all those having a common economic interest. Any person can become a member irrespective of his/her caste, creed, religion, colour, sex etc.

(c) Number of Members : A minimum of 10 members are required to form a cooperative society. In case of multi-state cooperative societies the minimum number of members should be 50 from each state in case the members are individuals. The Cooperative Society Act does not specify the maximum number of members for any cooperative society. However, after the formation of the society, the member may specify the maximum member of members.

(d) Registration of the Society : In India, cooperative societies are registered under the Cooperative Societies Act 1912 or under the State Cooperative Societies Act. The Multi-state Cooperative Societies are registered under the Multi-state Cooperative Societies Act 2002. Once registered, the society becomes a separate legal entity and attain certain characteristics. These are as follows.

(i) The society enjoys perpetual succession

(ii) It has its own common seal

(iii) It can enter into agreements with others

(iv) It can sue others in a court of law

(v) It can own properties in its name

(e) State Control : Since registration of cooperative societies is compulsory, every cooperative society comes under the control and supervision of the government. The cooperative department keeps a watch on the functioning of the societies. Every society has to get its accounts audited from the cooperative department of the government.

(f) **Capital :** The capital of the cooperative society is contributed by its members. Since, the members contribution is very limited, it often depends on the loan from government. and apex cooperative institutions or by way of grants and assistance from state and Central Government.

(g) **Democratic Set Up :** The cooperative societies are managed in a democratic manner. Every member has a right to take part in the management of the society. However, the society elects a managing committee for its effective management. The members of the managing committee are elected on the basis of one-man one-vote irrespective of the number of shares held by any member. It is the general body of the society which lays down the broad framework within which the managing committee functions.

(h) **Service Motive :** The primary objective of all cooperative societies is to provide services to its members.

(i) **Return on Capital Investment :** The members get return on their capital investment in the form of dividend.

(j) **Distribution of Surplus :** After giving a limited dividend to the members of the society, the surplus profit is distributed in the form of bonus, keeping aside a certain percentage as reserve and for general welfare of the society.

5.6.2 Types of Cooperative Societies

You know cooperative organisations are set up in different fields to promote the economic well-being of different sections of the society. So, according to the needs of the people, we find different types of cooperative societies in India. Some of the important types are given below.

(a) **Consumers' Cooperative Societies :** These societies are formed to protect the interest of consumers by making available consumer goods of high quality at reasonable price.

(b) **Producer's Cooperative Societies :** These societies are formed to protect the interest of small producers and artisans by making available items of their need for production, like raw materials, tools and equipments etc.

(c) **Marketing Cooperative Societies :** To solve the problem of marketing the products, small producers join hands to form marketing cooperative societies.

(d) **Housing Cooperative Societies :** To provide residential houses to the members, housing cooperative societies are formed generally in urban areas.

(e) **Farming Cooperative Societies :** These societies are formed by the small farmers to get the benefits of large-scale farming.

(f) **Credit Cooperative Societies :** These societies are started by persons who are in need of credit. Credit Co-operative Societies accept deposits from the members and grant them loans at reasonable rate of interest.

DO AND LEARN

Based on the above discussion as well as your understanding so far about the cooperative society form of business organisation, now you can try to fill up the following table.

Types of cooperative Societies	*Who form the Society*	*Objectives of the Society*	*Function of the Society*
1. Consumers' Cooperative Societies			
2. Producers' Cooperative Societies			
3. Marketing Cooperative Societies			
4. Housing Cooperative Societies			
5. Farming Cooperative Societies			
6. Credit Cooperative Societies			

5.6.3 Merits of Cooperative Society

The cooperative society is the only form of business organisation which gives utmost importance to its members rather than maximising its own profits. After studying its characteristics and different types, we may now study the merits of this form of business organisation.

(a) **Easy to Form :** Any ten adult members can voluntarily form an association get it registered with the Registrar of Cooperative Societies. The registration is very simple and it does not require much legal formalities.

Notes

(b) **Limited Liability :** The liability of the members of the cooperative societies is limited upto their capital contribution. They are not personally liable for the debt of the society.

(c) **Open Membership :** Any competent like-minded person can join the cooperative society any time he likes. There is no restriction on the grounds of caste, creed, gender, colour etc. The time of entry and exit is also generally kept open.

(d) **State Assistance :** The need for country's growth has necessitated the growth of the economic status of the weaker sections. Therefore, cooperative societies always get assistance in the forms of loans, grants, subsidies etc. from the state as well as Central Government.

(e) **Stable Life :** The cooperative society enjoys the benefit of perpetual succession. The death, resignation, insolvency of any member does not affect the existence of the society because of its separate legal entity.

(f) **Tax Concession :** To encourage people to form co-operative societies the government generally provides tax concessions and exemptions, which keep on changing from time to time.

(g) **Democratic Management :** The cooperative societies are managed by the Managing Committee, which is elected by the members. The members decide their own rules and regulations within the limits set by the law.

5.6.4 Limitations of Cooperative Society

Although the basic aim of forming a cooperative society is to develop a system of mutual help and cooperation among its members, yet the feeling of cooperation does not remain for long. Cooperative societies usually suffer from the following limitations.

(a) **Limited Capital :** Most of the cooperative societies suffer from lack of capital. Since the members of the society come from a limited area or class and usually have limited means, it is not possible to collect huge capital from them. Again, government's assistance is often inadequate for them.

(b) **Lack of Managerial Expertise :** The Managing Committee of a cooperative society is not always able to manage the society in an effective and efficient way due to lack of managerial expertise. Again due to lack of funds they are also not able to derive the benefits of professional management.

(c) **Less Motivation :** Since the rate of return on capital investment is less, the members do not always feel involved in the affairs of the society.

(d) **Lack of Interest :** Once the first wave of enthusiasm to start and run the business is exhausted, intrigue and factionalism arise among members. This makes the cooperative lifeless and inactive.

Notes

(e) **Corruption :** Inspite of government's regulation and periodical audit of the accounts of the cooperative society, the corrupt practices in the management cannot be completely ignored.

5.6.5 Suitability of Cooperative Society

You have already learnt that cooperative society form of business organisations is a voluntary association of persons who are not financially strong and cannot stand on their own legs to start and run the business individually. So to solve the common problem or to meet the common requirements, this form of business organisation is most suitable. Thus, people can join hands to get the consumer products, to build residential houses, for marketing the products, to provide loans and advances etc. This form of business organisation is generally suitable for small and medium size business operation.

INTEXT QUESTIONS 5.4

1. Define 'Cooperative Society' in your own words.
2. Answer the followings in one or two words.
   (a) Who manages the cooperative society?
   (b) How many members are required to start a multistate cooperative society?
   (c) Which type of cooperative society is formed to solve the credit need of the people?
   (d) To whom the application should be made for seeking registration of a cooperative society?
   (e) What is the maximum limit of membership in a cooperative society?
3. Match the following:

Column A	Column B
(a) Registration	(i) Limited
(b) Membership	(ii) Management
(c) Return on capital	(iii) Open to all
(d) Democratic	(iv) Compulsory
(e) Liability	(v) Dividend

WHAT YOU HAVE LEARNT

- On the basis of ownership and management there are different forms of business organisation. They are Sole Proprietorship, Partnership, Joint Hindu Family, Cooperative Society and Joint Stock Company.

- **Sole proprietorship** refers to a form of business organisation where a single individual owns and manages the business. He/she takes the profits and bears the losses. Merits of this form of business organisation include, easy to form and wind up, quick decision and prompt action, direct motivation, flexibility in operation. The businessman himself can give personal touch to each and every matter of the business that enables him to maintain the secrets of his business. Inspite of all these merits, this form also suffers from the limitations of limited resources, lack of continuity, unlimited liability of the owner, limited managerial expertise. This form is not suitable for large-scale operations.

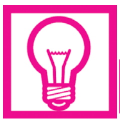
- **Partnership** is a form of business organisation in which two or more competent persons join hands to carry on any lawful business after entering into an agreement to share the profit and loss of the business. A partnership firm is easy to form and also flexible in its operation. It pools resources from the partners, makes their optimum utilisation by taking better decisions. It protects the interest of each and every partner and gets benefit out of the specialised knowledge and skills of individual partner. Since partners share the profits and losses they show keen interest in the affairs of the business. The major limitations of partnership form of business organisation are: unlimited liability, instability, limited capital, non-transferability of share and lack of harmony among the partners.

- In partnership firm we find different types of partners like Active partners, Sleeping partners, Nominal partners, Partners in profits, Limited partners, General partners. Partners by Estoppel and Partners by holding out.

- **Joint Hindu Family** form of business organisation is governed by Hindu Law. The members of the Hindu undivided family jointly own the business and the eldest member called Karta manages the business in the best possible manner. Every member called co-parcener gets an assured share in profit irrespective of their participation. The liability of co-parceners except the Karta is limited. The death or insolvency of any member does not affect the continuity of the business. This form of business organisation too suffers from certain limitations like limited resources, lack of motivation, scope for misuse of power by Karta and instability.

- **Cooperative society** is a voluntary association of persons who work together to promote their economic interest. It works on the principle of self-help and mutual help.

- The membership of cooperative societies is voluntary and open to all. It has separate legal existence and is democratically managed. The cooperative societies are easy to form and have a stable life. They get assistance from the government in the form of loan, grants and subsidies. The government also provides tax concession. The liability of the members is limited upto their capital contribution. Inspite of all these advantages, it also suffers from various limitations like insufficient capital, lack of managerial expertise. There is also lack of motivation in members due to absence of direct reward for individual efforts.
- According to the need of the people we find different types of cooperative societies in our country. Some of the important types are – Consumers cooperative societies, Producers' cooperative societies, Marketing cooperative societies, Housing cooperative societies, Farming cooperative societies and credit cooperative societies.
- **Suitability: Sole proprietorship** is suitable for simple business involving less capital and low risk. Business requiring manual skill like handicraft, filigree work, jewelry etc. are generally organised in the form of sole proprietorship. **Partnership** form of business is suitable for construction business, providing legal services, medical services etc. It is also suitable where capital requirement is medium. Business like wholesale trade, professional services, mercantile houses and small manufacturing units can be run in partnership form. **Joint Hindu Family** form of business organisation is suitable where the family inherits a running business and the members want to continue the business jointly. It is generally found that some of the trading business, banking and finance in unorganised sector, small industry, art and crafts etc. are run in the form of Joint Hindu family business. **Cooperative Society** form of business organisation is generally started to solve the common economic problems or to meet the common requirements of the weaker sections of the community. It is suitable for getting consumer goods at cheaper price, building houses, marketing products, providing loans and advances to the members etc.



KEY TERMS

Business Organisation	Karta	Partnership
Cooperative Society	Partner	Partnership Deed
Coparcener	Partner by Estoppel	Sole proprietorship
Firm	Partner by Holding Out	Unlimited Liability
Joint Hindu Family Business		

TERMINAL EXERCISE

Very Short Answer Type Questions

1. Define sole proprietorship.
2. List any two situations in which sole proprietorship form of business organisation is found to be most suitable
3. Who is a partner by estoppel?
4. Distinguish between partnership and sole proprietorship business on the basis of membership.
5. State the meaning of the term 'Coparcener'.

Short Answer Type Questions

6. State the suitability of sole proprietorship form of business organisation.
7. Explain any two limitations of partnership form of business organisation.
8. What is meant by 'partnership deed'? Is it essential for partnership?
9. Compare the status of a minor in partnership firm with that in a Joint Hindu Family business.
10. Mention any four characteristics a cooperative society gets after getting the registration certificate.

Long Answer Type Questions

11. Describe any four different types of partners.
12. What is a Joint Hindu Family business? Describe its main characteristics.
13. Explain the various merits of a Joint Hindu Family form of business organisation.
14. Give the definition of cooperative society as per the Indian Cooperative Societies Act 1912. State any two characteristics of cooperative society form of business organisation.
15. State the different types of cooperative societies that exist in India.
16. **There is a saying that it is always better to have a written aggrement. Keeping in view this saying it is always advisable for partners to have a written agreement. What is the name of this agreement and what are its contents in general?**
17. **You have gone through the various forms of business organisations. If you got an opportunity to start a business in the present scenerio which form of business organisation will you choose & why? Express your view with valid points.**

Notes

ANSWERS TO INTEXT QUESTIONS

5.1 2. (a) M (b) L (c) L (d) M (e) M

3. (a) - (iv) (b) - (i) (c) - (v) (d) - (iii) (e) - (ii)

5.2 1. A minor can only share the profits of the business.

2. (a) Maximum 10 members can join a banking business in partnership form.

(b) Partnership deed is always in the writing form.

(c) There is a principal agent relationship among the partners.

(d) In a partnership Hari and Madhu contributed Rs. 10,000 each Madhus's liability would be unlimited in case of losses in firm's business..

(e) A person can acquires interest in a partnership firm by entering into an agreement.

3. (a) Limited partner (b) Nominal Partner

(c) Partner in profit or Minor partner (d) Sleeping Partner/dormant partner

(e) Partner by holding out.

5.3 1. Since Karta has absolute power to manage the business as per his own will, he may misuse the authority for his personal gain. The clause unlimited liability restricts the Karta to do harm to the business.

2. (a) M (b) M (c) M (d) M (e) M

3. (a) Minimum two members are required in both the cases.

(b) Maximum 10 for banking and 20 for other business in case of partnership. Whereas there is no such limit fixed for Joint Hindu Family business.

(c) Membership is acquired by entering into agreement in partnership business. In Joint Hindu Family the membership is acquired by virtue of birth in the same family.

5.4 2. (a) Managing committee (b) 50 (Individual members)

(c) Credit Cooperative society (d) Registrar of Cooperative societies

(e) Maximum limit is not fixed by the Act. It is the members who can decide about the maximum limit of membership in the society if they so want.

3. (a) - (iv) (b) - (iii) (c) - (v)

(d) - (ii) (e) - (i)

Notes

DO AND LEARN

Make a survey of twenty business organisations in and around your locality. Classify them under the four categories you have learnt in this lesson. Analyse their nature of business, size of the business, number of owners etc. in a tabular form.

ROLE PLAY

1. Kamal and Nirmal are two friends. Nirmal wanted to start a wholesale business in partnership with Kamal. Kamal did not accept his proposal and started his own shop of selling readymade garments in a different locality. Nirmal started his business in partnership with another friend Vimal. One day both Kamla and Nirmal met in a function. Here is an extract of the conversion that took place between them.

   Nirmal : Hello, Kamal! How are you?

   Kamal : Hello, I am fine. How is your partnership working?

   Nirmal : It is running smoothly. Vimal is very sincere and cooperative. We are earning very good profit. But, still I miss you. Are you still not interested in partnership?

   Kamal : No, I am happy as a sole proprietor.

(Nirmal talked about the merits of partnership and limitations of sole proprietorship; whereas Kamal highlighted the merits of sole proprietorship and limitations of partnership)

Put yourself in place of Nirmal and a friend in place of Kamal and continue the dialogue.

2. In a Caffee, Kanika met one of her friends Prashant after a long period of time. Both of them discussed about their College days and asked each other about their present work.

   Kanika : Prashant, right now I am a partner in one of the reputed firms of Gujrat and the business is doing very well, what about you?

   Prashant : Its Good Kanika. I am also working as an M.D in Hazira (India) Pvt. Ltd. one of the petro products manufacturing Company.

   Kanika : It sound nice to listen MD. I and My partners were also thinking for quite a long time to convert our partnership firm into Pvt. Ltd. Co. but we are not sure, whether it would be possible or not, and now it is going to be different from partnership.

   Prashant : Dont worry I tell you all aspect

And the conversation continues.

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6

COMPANY FORM OF BUSINESS ORGANISATION

You must be aware that during the second five-year plan period five steel plants were established in India's underdeveloped areas to give a boost to the industrialization of the country. Do you know who owns these steel plants? It is the Government of India. It has set up a Joint Stock Company known as Steel Authority of India Limited (SAIL) for this purpose. You must have also heard the names of State Bank of India (SBI), National Thermal Power Corporation (NTPC), Grasim Industries Limited (GIL), Reliance Industries Limited (RIL) and Tata Steel Limited. These are all big business units and organised in the form of Joint Stock Companies. In this lesson we shall learn in detail about the Joint Stock Company; its merits and limitations; and also discuss the factors that influence the choice of form of business organisation.

OBJECTIVES

After studying this lesson, you will be able to:

- explain the meaning and characteristics of Joint Stock Company;
- identify different types of Joint Stock Companies;
- differentiate between Public Company and Private Company;
- explain the merits and limitations of Joint Stock Company and its suitability;
- identify the factors influencing the choice of an appropriate form of business organisation;
- distinguish between Joint Stock Company and Partnership; Joint Stock Company and Cooperatives; and
- explain the concept of Multinational Corporation and identify its merits and limitations.

6.1 JOINT STOCK COMPANY

In the previous lesson, you learnt in detail about four different forms of business organisation viz., Sole Proprietorship, Partnership, Joint Hindu Family Business, and Cooperative Society. You know that these forms are considered suitable for small and medium sized business. So if you want to set up a cement plant that requires a massive investment of crores of rupees, then what will you do?

You may think of forming a partnership firm for setting up the cement plant. But if you recall the limitations of Partnership form of business organisation, then definitely you will say- 'no'. Partnership may not be the suitable option for the business where huge capital investment is required. You know that there is a restriction on the membership of partnership, so it may not be possible to arrange the required amount of capital to set up a cement plant. Even if the people are capable of arranging the funds, nobody wants to take risk due to unlimited liability of partners. In such a situation company form of business organisation or Joint Stock Company may be the obvious choice whereby we can arrange large amount of capital easily from the members.

A Joint Stock Company or simply a company is a voluntary association of persons generally formed for undertaking some big business activity. It is established by law and can be dissolved by law. The company has a separate legal existence so that even if its members die, the company remains in existence. Its members contribute money for some **common purpose.** The money so contributed constitutes the **capital** of the company. The capital of the company is divided into small units called **shares**. Since members invest their money by purchasing the shares of the company, they are known as **shareholders** and the capital of the company is known as **share capital**.

In India, the joint stock companies are governed by the Companies Act, 1956. According to the Act, a company means 'a company formed and registered under this Act or an existing company'. An existing company means a company formed and registered under any of the previous Companies Acts. This definition is not exhaustive enough to reveal the basic features of the company. However, based on the definition given in the previous Companies Act and various judicial decisions, it can be defined as 'an artificial person created by law, having a separate legal entity, with a perpetual succession'.

6.2 CHARACTERISTICS OF JOINT STOCK COMPANY

You are now familiar with the concept of a company. Let us now study its characteristics.

(a) **Artificial Person :** A joint stock company is an artificial person in the sense that it is created by law and does not possess physical attributes of a natural person. It cannot eat or walk, smile or marry, read or write. However, it has a legal status like a natural person.

(b) **Formation :** The formation of a joint stock company is time consuming and it involves preparation of several documents and compliance of several legal requirements before it starts its operation. A company comes into existence only when it is registered under the Indian Companies Act. We shall learn in detail about the formation of joint stock company in the next lesson.

(c) **Separate Legal Entity :** Being an artificial person, a company exists independent of its members. It can make contracts, purchase and sell things, employ people and conduct any lawful business in its own name. It can sue and can be sued in the court of law. A shareholder cannot be held responsible for the acts of the company.

(d) **Common Seal :** Since a company has no physical existence, it must act through its Board of Directors. But all contracts entered by them shall have to be under the common seal of the company. This common seal is the official signature of the company. Any document with the common seal and duly signed by an officer of the company is binding on the company.

(e) **Perpetual Existence :** The company enjoys continuous existence. Death, lunacy, insolvency or retirement of the members does not affect the life of the company. It goes on forever. Since it is created by law, it can only be dissolved by law.

(f) **Limited Liability of Members :** The company form of business is able to attract large number of people to invest their money in shares because it offers them the facility of limited risk and liability. The liability of a member is limited to the extent of the amount of shares he holds. In other words, a shareholder can be held liable only to the extent of the face value of the shares he holds, and if he has already paid it, which is normally the case, he cannot be asked to pay any further amount. For example, if 'A' holds one share of Rs. 100 and has paid Rs. 75 on that share, his liability would be limited only upto Rs. 25.

(g) **Transferability of Shares :** The members of the company (Public company) are free to transfer the shares held by them to others as and when they like. They do not need the consent of other shareholders to transfer their shares.

(h) **Membership :** To form a joint stock company, a minimum of two members are required in case it is private limited company and seven members in case of public limited company. The maximum limit is fifty in case of private limited company. There is no maximum limit of membership for a public limited company.

(i) **Democratic Management :** You know that people of different categories and areas contribute towards the capital of a company. So, it is not possible for them to look after the day-to-day management of the company. They may take part in deciding the general policies of the company but the day-to-day affairs of the company are managed by their elected representatives, called Directors.

Notes

INTEXT QUESTIONS 6.1

1. If all the members of a joint stock company die in a road accident, then the company will be closed down. Do you agree with this statement? Give reasons in support of your answer.

2. Name the following in reference to a joint stock company.

   (a) The smallest unit into which the capital of company is divided.

   (b) The Act that governs the joint stock companies in India.

   (c) The sum total of the money contributed by the members of a joint stock company.

   (d) The official signature of a joint stock company.

   (e) The elected representatives of the members who manage the day to day affairs of the joint stock company.

6.3 TYPES OF JOINT STOCK COMPANIES

We have a large variety of companies in our country, which differ in respect of their mode of incorporation, jurisdiction of functioning, nationality and limit on membership. Of these, the most important ones are those based on limits on membership, namely, (1) Private Company, and (2) Public Company. Let us learn more about these two types.

(1) Private Company

Under the Companies Act, 1956, by 'Private Company' we mean a company, which has the following features –

(a) It cannot have more than 50 members. Employees of the company are not included in this.

(b) It cannot invite the public to purchase its shares and debentures through open invitation.

(c) It restricts the rights of the members to sell or transfer their shares.

(d) It must have a minimum paid up share capital of One lakh rupees.

The private companies have to follow all these conditions noted above. It is compulsory for these companies to write "Private Limited' after their names. The ownership of these companies is confined only to well-known selected persons. It requires minimum of two persons to start a private limited company. Usually, whenever partnership firms are in need of more money to expand their business, they convert themselves into private Companies. It may be noted that private companies are exempted from various regulations of the Companies Act. Infact they combine the advantages of both the company and the partnership form of business organisation.

(2) Public Company

For starting a business on a large scale, one needs a huge capital, which, even fifty members of a private company cannot provide. In such a situation, a public company is suitable. A public company means a company, which is not a private company. A public company must have the following features.

(a) It can invite the public to subscribe to its shares and debentures by open invitation.

(b) A minimum of seven members is required to establish a public company. There is no limit on the maximum number of its members.

(c) There is no restriction on the transfer of shares i.e., the shareholders are free to sell their shares to the public.

(d) The public company must have a minimum paid up capital of five lakhs rupees.

A public company must write public limited or simply limited after its name. Reliance Industries Limited, Bajaj Auto Limited, Hindustan lever Limited, Steel Authority of India Limited are examples of public companies.

In addition to the type of companies discussed above you must have come across many other types of companies like: Government company, Statutory company, Chartered company, Foreign company, Indian company, Multinational corporation, Holding company, and Subsidiary company.

Let us have a brief idea about all these.

(a) Government Company : Any company in which at least 51% of the paid up capital is held by the Government is known as government company. Example: Indian Telephone Industry (ITI), Bharat Heavy Electronics Limited (BHEL) etc.

(b) Statutory Company : A company created by a special Act of Parliament or state legislature is termed as statutory company. Example: Life Insurance Corporation of India (LIC), Securities Exchange Board of India (SEBI) etc.

(c) Chartered Company : A company created under a special charter granted by the king or queen of England. Example- East India Company.

(d) Foreign Company : A company which is incorporated in a country outside India and having business operation is India, is known as Foreign company. Example- Citi Bank, G.E. Capital, Honda Motors etc.

Notes

(e) **Indian/Domestic Company :** A company registered in India as per the Indian Companies Act is known as Indian/domestic company. Example- Associated Cement Company (ACC), Tata Iron and Steel Company (TISCO) etc.

(f) **Multinational Corporation (Company) :** A company which is registered in one country but carries on business in a number of other countries. We shall discuss in details about multinational corporations in the last section of this lesson.

(g) **Holding and Subsidiary Company :** If a company controls another company, the controlling company is termed as 'Holding Company' and the company so controlled is called a 'subsidiary company'.

A company may become a subsidiary company of another in the following circumstances:-

(i) When more than 50% of the nominal value of its equity share capital is under the control of another company.

(ii) When another company has control over the appointment of its Board of Directors.

(iii) When it is subsidiary of a company which itself is a subsidiary of another company. For example- Company 'B' is a subsidiary of company 'A" and company 'C' is a subsidiary of Company 'B'. Then company C becomes subsidiary of Company A.

6.4 DISTINCTION BETWEEN A PRIVATE COMPANY AND A PUBLIC COMPANY

Having learnt the meaning of a private company and a public company, you should now be able to distinguish between the two. The following are some of the main points of distinction between a private company and a public company.

	Basis of distinction	*Private Company*	*Public Company*
1.	Minimum number of members	A minimum of two members is required for a private company.	A minimum of seven members is required for a public company
2.	Maximum number of members	The maximum number of members in a private company is 50.	There is no limit on maximum number of members in public company
3.	Minimum paid up capital	A private company must have a minimum paid up capital of Rs. One lakh.	It must have a minimum paid up capital of Rs. Five lakh.
4.	Identification	A private company must suffix 'Private Limited' to its name.	A public company must suffix 'Limited' to its name.

5.	Transfer of Shares	The shareholders of a private limited company cannot transfer their shares	The shareholders of a public company can freely sell their shares to others.
6.	Invitation to the public to purchase shares and debentures	A private limited company cannot give open invitation to the public to subscribe to its shares and debentures.	A public company can invite the public to purchase its shares and debentures through the issue of prospectus.
7.	Commencement of business	A private limited company can start its business immediately upon its incorporation	A public limited company cannot start its business immediately after its incorporation. It has to obtain a certificate for starting or commencing its business.

Notes

INTEXT QUESTIONS 6.2

1. 'X' Company controls more than 50% of the nominal value of 'Y' Company's equity share capital. Hence 'X' Company is termed as holding company. State the other circumstances when a company can become a holding company.

2. Below are given certain characteristics of Joint stock company. Identify the characteristics of public limited company and private limited company from these statements and put tick mark in the circle of the boxes given after the statements.

   (a) There can be maximum of 50 members.

   (b) It can be started with minimum of seven members.

   (c) Its minimum paid up capital is five lakh rupees.

   (d) The shareholders cannot transfer its share.

   (e) It can invite the public to subscribe to its share.

Private Limited Company	Public Limited Company
(a) ○ (b) ○	(a) ○ (b) ○
(c) ○ (d) ○ (e) ○	(c) ○ (d) ○ (e) ○

3. Complete the following incomplete words by taking clues from the statements given for each. Every blank represents one letter only. First one has been done for you.

   (a) P __ __ L __ __ (PUBLIC) (b) F __ R __ __ __ N Company

Notes

(c) ST __ __ UT __ __ Y Company   (d) __ __ LD __ NG Company

(e) M __ L __ __ N __ __ IO __ AL Company

(f) G __ __ E __ N __ ENT Company

Clues

(a) A Company which requires minimum of seven members.

(b) A company which is incorporated outside India.

(c) A company created by a special Act of Parliament.

(d) A company that holds more than 50% share capital of another company.

(e) A company which carries on business in more than one country.

(f) A company in which atleast 51% paid up capital is held by the Government.

6.5 MERITS OF JOINT STOCK COMPANY

A company form of business organisation is very popular for undertaking big business. It has the following merits -

(a) Large Resources : A joint stock company can raise large financial resources because of its large number of members and it can raise funds through debentures, public deposits, loans from financial institutions without much difficulty.

(b) Limited Liability : In a joint stock company the liability of its members is limited to the extent of shares held by them. This attracts a large number of small investors to invest in the company. It helps the company to raise huge capital. Because of limited liability, a company is also able to take larger risks. This helps in making investment decisions easily.

(c) Continuity of Existence : A company is an artificial person created by law and possesses independent legal status. It is not affected by the death, insolvency etc. of its members. Thus, it has a perpetual existence.

(d) Benefits of Large-scale Operation : The joint stock company is the only form of business organisation which can provide capital for large-scale operations. It results in large-scale production consequently leading to increase in efficiency and reduction in the cost of operation. It further opens the scope for expansion.

(e) Liquidity : The transferability of shares acts as an added incentive to investors as the shares of a public company can be traded easily in the stock exchange. The public can buy shares when they have money to invest and convert shares into cash when they need money.

(f) **Professional Management :** Companies, because of the complex nature of their activities and large volume of business, require professional managers at every level of organisation. Because of the size of their business and the financial strength they can afford to appoint such managers. This leads to efficiency in management of their affairs.

(g) **Research and Development :** A company generally invests a lot of money on research and development for improved processes of production, designing and innovating new products, improving quality of product, new ways of training to its staff, etc.

(h) **Tax Benefits :** Although the companies are required to pay tax at a high rate, in effect their tax burden is low as they enjoy many tax exemptions under Income Tax Act.

6.6 LIMITATIONS OF JOINT STOCK COMPANY

Inspite of several merits of a joint stock company as discussed above, this form of business organisation also suffers from many limitations. The important limitations are given below:

(a) **Difficult to Form :** The formation of a company involves compliance with a number of legal formalities under the companies Act and compliance with several other rules and regulations framed by the government from time to time.

(b) **Control by a Group :** Theoretically a company is supposed to be managed by trained and experienced Directors. But practically this is not so in many cases. Most of the companies are managed by the Directors belonging to the same family. Since most of the shareholders are widely dispersed, they have indifferent attitude towards the management of the company. The shareholders holding majority of the shares take all decisions on behalf of the company. Thus, the democratic virtues of a company do not really exist in practice.

(c) **Excessive Government Control :** A company is expected to comply with the provisions of several Acts. Non-compliance with these, invites heavy penalty. This affects the smooth functioning of the companies.

(d) **Delay in Decision Making :** A company has to fulfill certain procedural formalities before making certain decisions, as they require the approval of the Board of Directors and /or the General Body of shareholders. Such formalities are time consuming and therefore, some important decisions may be delayed.

(e) **Lack of Secrecy :** It is difficult to maintain secrecy in many matters as they may require approval of board of directors and/or general body whose proceedings are usually open to public.

Notes

(f) **Social abuses :** A joint stock company is a large-scale business organisation having huge resources. This provides a lot of power to them. Any misuse of such power creates unhealthy conditions in the society e.g. having monopoly of a particular business, industry or product; influencing politicians and government in getting their work done; exploiting workers, consumers and investors, etc.

INTEXT QUESTIONS 6.3

1. Mr. Mohit has invested Rs. 2 lakh in shares of a public limited company. After one year he noticed that the company does not perform well, and the market value of its shares is going down. He thinks, if this situation continues, he will lose his Rs. 2 lakh rupees and if required his house will be sold out to discharge his liabilities of the company. Is he thinking in the right direction. Give reason in support of you answer.

2. Below are given certain statement. Put 'M' in the box given at the end of the sentence, if it is the merit and 'L' if it is limitation of joint stock company.

   (a) The liability of the members of joint stock company is limited.

   (b) The shares of the public limited company can be traded easily in the stock exchange.

   (c) A number of legal formalities have to be complied with in the formation of joint stock company.

   (d) The shareholders holding majority of shares take all decisions of the company.

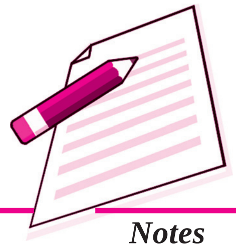
   (e) A company can spend a lot of money on research and development for improved process of production, designing and innovating new products.

6.7 SUITABILITY OF JOINT STOCK COMPANY

A joint stock company is suitable where the volume of business is large, the area of operation is widespread, the risk involved is high and there is a need for huge financial resources and manpower. It is also preferred when there is need for professional management in its operations. In certain businesses like banking and insurance, joint stock company form is the most suitable. Now-a-days, it is a preferred form for most areas of business because of the preference for operating on large scale.

6.8 CHOOSING THE RIGHT FORM OF ORGANISATION

You have already learnt about different forms of business ownership, i.e., Sole Proprietorship, Partnership, Joint Hindu Family Business, Company and Cooperative



Notes

Society. You must have noticed that no particular form of business organisation can meet all kinds of our requirements. Some may require more financial and managerial resources while others involve large risk. That is the reason why we find different forms of business organisations prevailing in our economy. So while selecting a form of business organisation, we analyse different factors and try to choose the most suitable form according to our financial and managerial capabilities. We will now study those factors which may help us in selecting the right form of business organisation.

(a) **Ease of formation :** A sole trader can commence and withdraw from business at any time at his own option. In partnership, mutual trust and faith is very much required. Company requires many legal formalities for its formation. Sole proprietorship is therefore the easiest to form.

(b) **Availability of Large Resources :** One-man business is the best in the world if the owner has enough resources and ability to manage. This statement shows that a single person is unable to undertake big business mainly because of limited resources and managerial ability. In partnership also the financial resources of partners are limited. Therefore, only a company can raise enough capital and hire expert knowledge required for the management of a big business.

(c) **Liability or Risk :** We know that liability of members is unlimited both in sole proprietorship and partnership and limited in case of a company and cooperative societies. Since members hesitate to undertake big risk, they prefer to invest in a company.

(d) **Stability :** Stability is essential for the success of any business. The existence of a company and cooperative society does not depend on the health and wealth of its members. Sole proprietorship and partnership forms are dissolved but company form of an organisation continues irrespective of the death or insolvency of any of its members.

(e) **Flexibility :** An ideal form of business must have flexibility in operations. Decisions must be taken quickly and implemented promptly for its functioning. Any rigidity in its functioning will not be beneficial for the survival and growth of a business.

A company enjoys better flexibility whenever more finances are required. It can raise more capital and include more members whenever needed. In a partnership, the number of members at any time cannot exceed 20. In sole proprietorship there is only one owner and availability of finances is also limited.

But flexibility in operations is maximum in sole proprietorship. He does not require approval of other members as in partnership or compliance with the provisions of the Act as in a company. Hence, the change in the nature of business or its operations is easiest in the case of sole proprietorship.

Notes

(f) **Secrecy :** Sole trader is the master of his entire business. He does not need to share his secrets with any one. Partnership is organised on the basis of mutual agency and therefore all the partners have the right to know everything about the business. A company is required to file a number of documents and publish its annual reports. Therefore secrecy is the least in case of a company.

(g) **Extent of State Control :** While it is not possible altogether to avoid compliance with governmental regulations the entrepreneur will always like to choose that form of business organisation which has minimum government interference. A company has to fulfill many legal formalities before it can commence its business. Even after the formation, it has to comply with various legal provisions. In sole proprietorship and partnership, the government control is comparatively less.

Following table presents a summary and comparisons of different characteristics of sole proprietorship, partnership and company.

Characteristics	*Most advantageous form*	*Least advantageous form*
(i) Availability of finances.	Company	Sole proprietorship
(ii) Cost of organising and dissolving.	Sole proprietorship	Company
(iii) Ease of organising and dissolving.	Sole proprietorship	Company
(iv) Ease of transferring or withdrawing ownership.	Company	Partnership
(v) Efficiency in management.	Company	Sole Proprietorship
(vi) Freedom to operate in any state.	Sole proprietorship	Company
(vii) Government controls and restrictions.	Sole proprietorship	Company
(viii) Length of life.	Company	Sole Proprietorship
(ix) Simplicity of operations.	Sole proprietorship	Company

INTEXT QUESTIONS 6.4

1. A Joint Stock Company is suitable where the volume of business is large, the area of operation is widespread and the risk involved is high. What are other conditions under which Joint Stock Company is more suitable. Write any two such conditions.

2. There are a number of factors that determine the choice of a particular form of business organization. Name the form of organization i.e., either sole proprietorship or joint stock company which may be preferred keeping in mind the following factors:

   (a) It can raise huge capital and hire expert knowledge to manage a big business.

(b) Maximum secrecy can be maintained.

(c) The government controls is very little.

(d) Death or insolvency of a member does not affect the existence.

(e) Flexibility in operations is maximum.

Notes

6.9 DIFFERENCES BETWEEN VARIOUS FORMS OF BUSINESS ORGANISATION

We have learnt about the various forms of business organisation. If we analyse their characteristics we find that each one is different from the other. Let us try to distinguish between some of these forms of business organisation.

Difference between Partnership and Joint Stock Company

Basis	*Partnership*	*Joint Stock Company*
1. Formation	It is easy to form as registration is not compulsory.	It requires many legal formalities to be completed before the company comes into existence.
2. Operation	Governed by the Indian Partnership Act, 1932.	Governed by the Companies Act, 1956.
3. Membership	Minimum is two, maximum is 10 in banking business and 20 in other business.	In case of Private Company minimum is 2, maximum is 50; in case of Public company minimum is 7 and there is no maximum limit.
4. Legal Status	No separate legal entity.	Separate legal entity from that of its members.
5. Liability	Joint and several to an unlimited extent.	Limited to the face value of shares held.
6. Management	All or any one on behalf of all partners are entitled to manage.	Board of Directors is authorised to manage.
7. Transfer of Shares	Consent of all partners is required.	Shares are freely transferable.
8. Existence	Dissolves with the death, retirement or insanity of a partner.	Perpetual existence; unaffected by death, retirement, insolvency etc. of the shareholders.

9. Finance	Relatively limited scope for raising finance.	Vast and unlimited scope for raising finance.

Difference between Joint Stock Company and Co-operative Society

Basis	*Joint Stock Company*	*Co-operative Society*
1. Formation	Comes into existence when registered with the Registrar of Companies.	Comes into existence when registered with the Registrar of Co-operative Societies.
2. Membership	Members can be from the whole country or from any other country of the world. Minimum number of members for a Private company is 2 and for a Public company it is 7. The maximum membership for the former is 50 and for the latter is not fixed.	Members are mostly from a particular locality or a region. The minimum membership is 10 and maximum is not fixed.
3. Purpose	Usually run a business to earn profit.	To render services to its members in particular and to the society in general.
4. Operation	Governed by the Companies Act, 1956	Governed by the Co-operative Societies Act, 1912, Multi-state Cooperative Societies Act 2002 and State Co-operative Societies Acts.
5. Management	Managed by Board of Directors, elected by the shareholders. Each shareholder has as many votes as the number of share holders.	Managed by a Managing Committee elected by members on the basis of one member, one-vote.
6. Transfer of Interest	Shares are freely transferable and passed on to the legal heirs (except in case of private company).	Shares are not easily transferable, but can be passed on to legal heirs or reverted back to the society at the Member's discretion.

Notes

7. Liability	Liability of its members is limited to the value of shares held.	Liability of its members is limited but the society may opt for unlimited liability.
8. Payment of Dividend	The rate of dividend is decided by the company every year and it may vary.	A fixed rate of dividend is payable to its members as per the provisions of the Cooperative Societies Act.

6.10 MULTINATIONAL CORPORATION

In our day-to-day life we use different goods of Indian as well as foreign origin. The foreign goods are either imported to our country or these goods are produced in our country by the foreign companies. You must be thinking why foreign companies are coming to our country. Actually they came to India to produce goods and services and/ or to sell their products. Similarly, Indian Companies are also extending their business operations across the boundaries of our country. This is called globalization, which means extension of economic activities across the boundaries of a country in search of world wide market.

6.10.1 Meaning and Features of Multinational Corporation

Simply speaking, a multinational corporation (also termed as multinational companies) is one which is registered as a company in one country but carries on business in a number of other countries by setting up factories, branches or subsidiary units. Such a company may produce goods or arrange services in one or more countries and sell these in the same or other countries. You might have heard about many Multinational Corporations (MNCs) running business in India, Hyundai Motor Company, Coca Cola Company, Sony Corporation, McDonald's Corporation, Citi Bank, etc.

All these corporations generally have production, marketing and other facilities in several countries. Their volume of sales, profits earned, and also the value of assets held by them are generally very large. They have set up their branches and subsidiary units in our country and also in other countries. They are controlled from the headquarters of these companies in the home country, which lay down broad policies to be pursued.

Features of Global Enterprises (MNCs)

The main features of the multinational company are the following :

1. **Centralised Management :** A multinational company has its headquarter in the home country. It expands its business in other countries by opening branches and subsidiary companies in other countries. The management of the business being carried out in other countries is in the hands of the head office. All the branches and subsidiaries have to work according to the policies laid down by the head office.

2. **Worldwide Spread of Business :** The business of the multinational company is spread in many countries. This company fully exploits the local conditions prevailing in the host countries. This includes the availability of cheap labour and the use of raw material.

3. **Better Quality Products :** A multinational company has to compete on the world level, it has, therefore, to pay special attention to the quality of its products.

4. **Large Size :** A multinational company has huge assets. The value of the assets of IBM is approximately 8 billion dollars. Similarly, another company ITT has 800 branches in 70 countries.

5. **Access to International Market :** A multinational company easily establishes its identity in the international market because of its many products, good quality, research on a large scale, good marketing facilities, etc.

6. **Special Attention to Advertisement :** A multinational company pays special attention to advertisement. That is the secret of its success.

6.10.2 Advantages of Multinational Corporation

The Multinational Corporations enjoy several advantages by way of huge earnings due to large-scale production and distribution activities across national borders. Besides, the host countries in which the Multinational Corporations operate also derive a number of advantages. These are:

(a) **Investment of Foreign Capital :** Direct investment of capital by multinational corporation helps under-developed countries to speed up their economic development.

(b) **Generation of Employment :** Expansion of industrial and trading activities by multinational corporation leads to creation of employment opportunities and raising the standard of living in host countries.

(c) **Use of Advanced Technology :** With substantial resources multinational corporation undertake Research and Development activities which contribute to improved methods and processes of production and thus, increase the quality of products. Gradually, other countries also acquire these technologies.

(d) **Growth of Ancillary Units :** Suppliers of materials and services and ancillary industries often grow in host countries as a result of the operation of multinational corporation.

(e) **Increase in Exports and Inflow of Foreign Exchange :** Goods produced in the host countries are sometimes exported by multinational corporation. Foreign exchange thus earned contributes to the foreign exchange reserves of host countries.

(f) **Healthy Competition :** Efficient production of quality goods by multinational corporations prompt the domestic producers to improve their performance in order to survive in the market.

6.10.3 Limitations of Multinational Corporation

The advantages discussed above are no doubt beneficial to host countries. But there are several limitations of multinational corporation, which we should take note of:

(a) **Least Concern for Priorities of Host Countries :** Multinational corporations generally invest capital in the most profitable industries and do not take into account the priorities of developing basic industries and services in backward regions of the host country.

(b) **Adverse Effect on Domestic Enterprises :** Due to large-scale operation and technological skills, multinational corporations are often able to dominate the markets in host countries and tend to acquire monopoly power. Thus, many local enterprises are compelled to close down.

(c) **Change in Culture :** Consumer goods, which are introduced by multinational corporations in the host countries, do not generally conform to the local cultural norms. Thus, consumption habits of people as regards food and dress tend to change away from their own cultural heritage.

6.10.4 Joint Ventures

Joint venture is a form of business, where two or more independent firms contribute capital and participate in business operations, these two organisations may be private or government organisations or a foreign company. In joint venture, business concerns join together for a specified purpose. It facilitates pooling funds, technical knowhow & managerial skills. The rewards and risks will be shared by the concerns in joint venture. e.g. Maruti Ltd. of India and Suzuki Ltd. of Japan joined hands to form Maruti Suzuki India Ltd. which is a joint venture concern.

Features of Joint Venture

1. **Access to advanced Technology :** When two or more companies join together, there can be access to latest techniques of production. This will lead to cost reduction and improvement in quality and increased production.

2. **Optimum Use of Capital :** Joint Venture helps in the optimum utilisation of capital. There will be least wastage of capital and other resources.

3. **Pooling of Resources and Expertise :** The resources of two or more companies can be effectively pooled by forming a joint venture. This helps in large scale production and can avail economies of large scale production.

Notes

4. **Innovation :** It the highly competitive market, the ideas and technology of two enterprises will help to innovative new ideas and products.

5. **Sharing of Risk and Reward :** The enterprises which join hands to form joint venture will share the reward in the form of increased profit. The partners in joint venture have to share the risk that may occur in business.

6.10.5 Public Private Partnership (PPP)

Public Private Partnership means partnership between public sector and private sector in financing, designing and developing infrastructural facilities. In a PPP, the private sector may contribute money, expertise and technical knowhow. Infrastructures like power, transport, education, healthcare, waste management etc are maintained through PPPs.

Features of Public Private Partnership

1. PPP projects are for the benefit of public.
2. Government remains actively involved throughout the life of a PPP project.
3. PPPs are mainly used in government projects of higher priority.
4. In a PPP project, the funds, expertise and experience of both the private and public sectors are combined.
5. In a PPP project, the degree of responsibility and the level of risk are shared between private and public sector.

Merits of Public Private Partnership

1. PPPs approach helps in faster implementation of projects.
2. It helps in higher quality services as there is a combined expertise of public and private sector.
3. It helps to reduce costs due to efficient management practices.
4. In PPPs the risk is divided between the government and the private sector.
5. In PPPs, the funds are invested both by the public and the private sector. So government is relieved of the botheration to borrow money.
6. The government is accountable for the cost and quality of public services.

Demerits of Public Private Partnership

1. Private sector aims at profit maximisation, but such an approach may not be desirable for public works.
2. There is possibility of leakage of important secrets of the country.

3. Sometimes there may be delays in the completion of crucial projects because of the conflicts between the government and the private firm.

Notes

INTEXT QUESTIONS 6.5

1. State the general features of Multinational Corporation.

2. Following points distinguish a joint stock company, partnership and cooperative society from each other. Joint the points with the relevant form of business organization given in the circle by drawing arrows.

   (a) The different forms of business organization being governed by different Acts passed in the year –

   (i) 1932 (ii) 1956 (iii) 1912

   Joint Stock Company
   Cooperative Society
   Partnership

   (b) Minimum number of members required to form:

   (i) 2 (ii) 7 (iii) 10

   Public Ltd. Company
   Cooperative Society
   Partnership

   (c) Maximum number of members:

   (i) 50 (ii) 20 (iii) No limit

   Cooperative Society
   Private Limited Company
   Partnership

   (d) Management

   (i) Managed by an Elected committee (ii) Managed by one or more members (iii) Managed by elected board of directors

   Joint Stock Company
   Cooperative Society
   Partnership

3. Multiple Choice Questions.

i. A form of business organisation that has been set up jointly by two different business firms is known as:

a) Sole proprietorship b) Joint venture

c) Co-operative society d) Public company

ii. Name of the organisation set up as a result of the partnership between public sector and private sector is

a) Sole proprietorship b) Public company

c) Public Private Partnership d) Co-operative society

WHAT YOU HAVE LEARNT

- A joint stock company is an artificial person, having a separate legal entity, with a perpetual succession.
- Characteristics of joint stock company:
  - It is an artificial person
  - Its formation involves a lot of legal procedures and it is time consuming.
  - It has a separate legal entity
  - It has an official signature known as common seal
  - It has perpetual existence
  - The liability of its members is limited
  - The members are free to transfer their shares
  - Joint stock company is managed in a democratic way
- Types of company
  - Private company
  - Public company
  - Government company
  - Statutory company
  - Chartered company
  - Foreign company

- Indian company
- Multinational corporation (company)
- Holding company
- Subsidiary company

- Merits of joint stock company: A joint stock company can arrange large resources. Its members enjoy the benefits of limited liability. It has perpetual existence. The benefits of large scale business operation can only be derived from this form of organization. Its shares are easily transferable. It derives the benefit of professional management in its operation.

- Limitations of joint stock company: The formation of a joint stock company involves compliance with a number of legal formalities. It suffers from the limitations of excessive government control. It is very difficult to maintain secrecy in the business. All important decisions require the approval of Board of Directors or General body of the shareholders. So it takes more time in taking certain decisions. The joint stock companies are practically managed by a specific group of people. The shareholders who are scattered all over the country, generally do not take keen interest in each and every matter of their company.

- Suitability of joint stock company: A joint stock company is suitable where volume of business is large, area of operation is widespread, risk involved is high and there is a need for huge financial return and manpower.

- Choosing the right form of organisation: The following factors may be considered while choosing a suitable form of business organization: (a) Ease of formation; (b) Availability of resources; (c) Liability or risk; (d) Stability; (e) Flexibility; (f) Secrecy; (g) Extent of state control

- Multinational corporation: A business unit that is registered as a company in one country but carries on its business in a number of other countries by setting up factories, branches and subsidiary units is called a multinational corporation.

- Merits of Multinational corporation : (a) Investment of foreign capital; (b) Generation of employment; (c) Use of advanced technology; (d) Growth of ancillary units; (e) Increase in exports and inflow of foreign exchange; (f) Healthy competition with domestic companies

- Limitations of multinational corporations : (a) Least concern for priorities of host countries; (b) Adverse effect on domestic enterprises; (c) Change in culture of the people.

- A joint venture is an enterprise set up jointly by two or more business concerns. It helps in pooling the funds, technical knowhow and managerial skills.

- Access to advanced technology, proper use of capital, pooling of resources, expertise, innovation and sharing of risk and reward are the features of joint venture type of enterprise.
- A PPP is a partnership between a private sector enterprise and a public sector enterprise.
- Active government involvement, pooling of funds, expertise and experience, sharing of risk and responsibility etc. are the features of PPP form of enterprise.
- Faster implementation, high quality services, sharing of risk, accountability of the government are the merits of PPP.
- Demerits of PPP form of enterprise – leakage of important secrets of the country, conflicts between government and private enterprise.

KEY TERMS

Artificial person	Indian company	Share
Chartered company	Multinational corporation	Share capital
Common seal	Perpetual existence	Shareholder
Foreign company	Private company	Statutory company
Government company	Public company	Subsidiary company
Holding company	Separate legal entity	

TERMINAL EXERCISE

Very Short Answer Type Questions

1. In joint stock company what is meant by the term 'share'?
2. State the meaning of the term 'Company' as per the Companies Act 1956.
3. What is meant by multinational corporation?
4. State the difference between a public company and a private company as far as the commencement of business is concerned.
5. How do you identify a public company and a private company just by seeing their names?
6. What is meant by Public Private Partnership?
7. Name a form of organisation that is formed by combined efforts of two or more independent firms?

Short Answer Type Questions

8. State how the company is as artificial person.
9. Enumerate the features of a public company.
10. Distinguish between private company and public company on the basis of members and paid up capital.
11. State the suitability of joint stock company form of business organisation.
12. What conditions are required to be fulfilled by a private company?
13. What is meant by a joint venture?
14. List any three merits of Public Private Partnership.

Long Answer Type Questions

15. Explain, why the joint stock company form of business organisation is advisable to undertake huge and risky projects.
16. Describe any five characteristics of joint stock company.
17. You were running your business in partnership, but now you have formed a joint stock company. What difference did you notice in respect of
    (a) legal status,
    (b) liability, and
    (c) finance
18. Explain any five advantages of multinational corporation for the host country.
19. State any five factors required to be considered while choosing the right form of business organisation.
20. Discuss briefly the features of Joint Venture.
21. Explain the merits and demerits of Public Private Partnerships.
22. **You are appearing as a condidate in an interview in a Public Ltd. Co. One of the members of the interview board asks you the difference between a Public Company and a Private Company. Express your views to satisfy the interview board with the help of any 5 points.**
23. **A news about a Joint venture of Indian Company and Japanese Company made you to think about, what it is all about. You try to get some information from your self learning materials & some from internet. Explain in brief about your findings related to joint venture.**

Notes

ANSWERS TO INTEXT QUESTIONS

6.1 1. No, since the company has perpetual existence. It can continue working with new members.

2. (a) Share (b) Companies Act 1956 (c) Share capital
(d) Common seal (e) Directors

6.2 1. (a) If the company has control over the appointment of the Board of Directors of another company
(b) When its subsidiary company is the holding company of another company.

2. Private limited company (a) (d)
Public limited company (b) (c) (e)

3. (b) FOREIGN (c) STATUTORY (d) HOLDING
(e) MULTINATIONAL (f) GOVERNMENT

6.3 1. No. The liabilities of the shareholders is limited. Again, he has the option to transfer or sell the shares to avoid further loss.

2. (a) M (b) M (c) L (d) L (e) M

6.4 1. (a) Need for professional management (b) Huge financial requirement
(c) More manpower requirement

2. (a) Joint stock company (b) Sole proprietorship
(c) Sole proprietorship (d) Joint stock company
(e) Sole proprietorship.

6.5 1. (a) International Operation (b) Large size (c) Centralised control

2. (a) (i) 1932 – Partnership (ii) 1956 – Joint Stock company
(iii) 1912 – cooperative society

(b) (i) 2 - Partnership (ii) 7 – Public limited company
(iii)10 – cooperative society

(c) (i) 50 – Private limited company (ii) 20 – Partnership
(iii) No limit – Cooperative society

(d) (i) Managed by elected committee – Cooperative society
(ii) Managed by one or two members – Partnership
(iii) Managed by elected board of directors – Joint stock

3. (i) b (ii) c

Notes

DO AND LEARN

1. Collect various information about atleast five multinational corporations and prepare a chart as given below

Name of the company					
Country where its head office is located					
Other countries it has operations in					
Goods and/or services it deals in					

ROLE PLAY

1. Sudhir and Sushil are two friends and belong to the same village. They met after a long time in a festival. Both of them used to be partners of a firm. But Sushil left the firm five year back and joined a public limited company as a director.

   The following conversation took place between them.

   Sudhir : Hello Sushil. How are you? How is your company going on?

   Sushil : Hi Sudhir. I am fine. Our company is also doing very good business. This year our profit crossed five crore rupees.

   Sudhir : That's good. But to earn such profit, your company must have invested huge amount in its activities. Isn't it? But from where did you get all this money?

   Sushil : Actually in a public limited company, it is possible to collect large amount of money because the number of members is large. Another thing, they invest money without any risk because their liability is limited

Why don't you convert you partnership business in to a joint stock company, atleast a private limited company. (Sudhir was keen to know about the features, merits, limitations and suitability of joint stock company. Sushil explained to him. The conversion between both the friends was going on).

(Place yourself as Sudhir and one of your friends as Sushil. Enact these roles and make your study interesting).

2. You are working as a manager in an Indian Company for the last few years. You receive a call to join a Multinational Company, about which you informed to your seniors. About which they discussed with you.

   Chief Manager : Satish, why do you want to leave our company. You are holding a good position and that too in a company of national level.

   Satish : Sir, you are absolutely right, but I am getting an opportunity in Multinational Company.

Continue the discussion of Satish with Chief Manager so as to convince him to join MNC.

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7

PUBLIC SECTOR ENTERPRISES

You have learnt about various forms of business organisations, which primarily relate to private enterprises. Traditionally, business activities were left mainly to individual and private organisations, and the government was taking care of only the essential services such as railways, electricity supply, postal services etc. But, it was observed that private sector did not take interest in areas where the gestation period was long, investment was heavy and the profit margin was low; such as machine building, infrastructure, oil exploration, etc. Not only that, industries were also concentrated in some regions that had certain natural advantages like availability of raw materials, skilled labour, nearness to market. This led to regional imbalances. Hence, the government while regulating the business activities of private enterprises went in for direct participation in business and set up public enterprises in areas like coal industry, oil industry, machine building, steel manufacturing, finance and banking, insurance etc. These units are not only owned by central, state or local government but also managed and controlled by them and are termed as Public Sector Enterprises. In this chapter, you will learn about the nature and characteristics of public enterprises and the forms of their organisation.

OBJECTIVES

After studying this lesson, you will be able to:

- state the meaning of public sector enterprises;
- identify the main characteristics of public sector organisations;
- distinguish between public sector and private sector;
- describe different forms of organisation of public sector enterprises;
- state the features, merits and limitations of Departmental Undertakings, Public Corporations and Government Companies;

- explain the importance of public sector enterprises; and
- outline the current scenario of public enterprises.

7.1 MEANING OF PUBLIC ENTERPRISES

As state earlier, the business units owned, managed and controlled by the central, state or local government are termed as public sector enterprises or public enterprises. These are also known as public sector undertakings.

A pubic sector enterprise may be defined as any commercial or industrial undertaking owned and managed by the government with a view to maximise social welfare and uphold the public interest.

Public enterprises consist of nationalised private sector enterprises, such as, banks, Life Insurance Corporation of India and the new enterprises set up by the government such as Hindustan Machine Tools (HMT), Gas Authority of India (GAIL), State Trading Corporation (STC) etc.

7.2 CHARACTERISTICS OF PUBLIC ENTERPRISES

Looking at the nature of the public enterprises, their basic characteristics can be summarised as follows:

(a) **Government Ownership and Management :** The public enterprises are owned and managed by the central or state government, or by the local authority. The government may either wholly own the public enterprises or the ownership may partly be with the government and partly with the private industrialists and the public. In any case the control, management and ownership remains primarily with the government. For example, National Thermal Power Corporation (NTPC) is an industrial organisation established by the Central Government and part of its share capital is provided by the public.

(b) **Financed from Government Funds :** The public enterprises get their capital from Government Funds and the government has to make provision for their capital in its budget.

(c) **Public Welfare :** Public enterprises are not guided by profit motive. Their major focus is on providing the service or commodity at reasonable prices. Take the case of Indian Oil Corporation or GAIL India Limited. They provide petroleum and gas at subsidised prices to the public.

(d) **Public Utility Services :** Public sector enterprises concentrate on providing public utility services like transport, electricity, telecommunication etc.

(e) **Public Accountability :** Public enterprises are governed by public policies formulated by the government and are accountable to the legislature.

(f) **Excessive Formalities :** The government rules and regulations force the public enterprises to observe excessive formalities in their operations. This makes the task of management very sensitive and cumbersome.

Notes

7.3 DIFFERENCE BETWEEN PRIVATE AND PUBLIC SECTOR ENTERPRISES

In the earlier lessons you have studied about the various forms of business organisation existing under private ownership or in private sector. By private sector, we mean, economic and social activities undertaken privately by a single individual or group of individuals. They prefer to do business in private sector basically to earn profit.

On the other hand public sector refers to economic and social activities undertaken by public authorities. The enterprises in public sector are set up with the main aim of protecting public interest. Profit earning comes next.

Besides the difference in the objective, the enterprises in both these sectors also differ in many other aspects. In this section let us know the differences between the enterprises of public sector and private sector.

Basis of difference	*Private sector enterprises*	*Public sector enterprises*
1. Objective	Maximisation of profit.	Maximise social welfare economic and ensure balanced development.
2. Ownership	Owned by individuals.	Owned by Government.
3. Management	Managed by owner and professional managers.	Managed by Government.
4. Capital	Raised by owners through loans, private sources and public issues.	Raised from Government funds and sometimes through public issues.
5. Area of operation	Operates in all areas with adequate return	Operates in basic and public utility sectors. on investment.

INTEXT QUESTIONS 7.1

1. What is meant by public sector?

2. State whether the following statements are true or false and correct the statements if needed.


Notes

(a) The objective of private sector enterprises is welfare of the customers.

(b) The public sector enterprises are managed by professional managers.

(c) The private sector enterprises concentrate on area of public utility services.

(d) The private sector enterprises are owned and managed by private individuals.

(e) The public enterprises are totally funded by the public.

7.4 FORMS OF ORGANISATION OF PUBLIC ENTERPRISES

There are three different forms of organisation used for the public sector enterprises in India. These are (1) Departmental Undertaking; (2) Statutory (or Public) Corporation, and (3) Government Company.

Departmental Undertaking form of organisation is primarily used for provision of essential services such as railways, postal services, broadcasting etc. Such organisations function under the overall control of a ministry of the Government and are financed and controlled in the same way as any other government department. This form is considered suitable for activities where the government desires to have control over them in view of the public interest.

Statutory Corporation (or public corporation) refers to a corporate body created by the Parliament or State Legislature by a special Act which define its powers, functions and pattern of management. Statutory corporation is also known as public corporation. Its capital is wholly provided by the government. Examples of such organisations are Life Insurance Corporation of India, State Trading Corporation etc.

Government Company refers to the company in which 51 percent or more of the paid up capital is held by the government. It is registered under the Companies Act and is fully governed by the provisions of the Act. Most business units owned and managed by government fall in this category.

PUBLIC ENTERPRISES

Departmental Undertaking

Example
1. Posts & Telegraph
2. Railways
3. All india Radio (AIR)
4. Door Darshan (TV)
5. Ordinance Factories

Statutory Corporations

Example
1. Food Corporation of India
2. Industrial Finance Corporation of India
3. Life Insurance Corporation of India
4. Unit Trust of India
5. State Trading Corporation

Government Companies

Example
1. Hindustan Machine Tools Limited
2. Steel Authority of India Limited
3. Hindustan Shipyard Limited

7.5 DEPARTMENTAL UNDERTAKINGS

Departmental undertakings are the oldest among the public enterprises. A departmental undertaking is organised, managed and financed by the Government. It is controlled by a specific department of the government. Each such department is headed by a minister. All policy matters and other important decisions are taken by the controlling ministry. The Parliament lays down the general policy for such undertakings.

7.5.1 Features of Departmental Undertakings

The main features of departmental undertakings are as follows:

(a) It is established by the government and its overall control rests with the minister.

(b) It is a part of the government and is managed like any other government department.

(c) It is financed through government funds.

(d) It is subject to budgetary, accounting and audit control.

(e) Its policy is laid down by the government and it is accountable to the legislature.

7.5.2 Merits of Departmental Undertakings

The following are the merits of departmental undertakings :

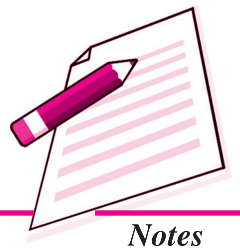
(a) Fulfillment of Social Objectives : The government has total control over these undertakings. As such it can fulfill its social and economic objectives. For example, opening of post offices in far off places, broadcasting and telecasting programmes, which may lead to the social, economic and intellectual development of the people are the social objectives that the departmental undertakings try to fulfill.

(b) Responsible to Legislature : Questions may be asked about the working of departmental undertaking in the parliament and the concerned minister has to satisfy the public with his replies. As such they cannot take any step, which may harm the interest of any particular group of public. These undertakings are responsible to the public through the parliament.

(c) Control Over Economic Activities : It helps the government to exercise control over the specialised economic activities and can act as instrument of making social and economic policy.

(d) Contribution to Government Revenue : The surplus, if any, of the departmental undertakings belong to the government. This leads to increase in government income. Similarly, if there is deficiency, it is to be met by the government.

(e) Little Scope for Misuse of Funds : Since such undertakings are subject to budgetary accounting and audit control, the possibilities of misuse of their funds is considerably reduced.



Notes

7.5.3 Limitations of Departmental Undertakings

Departmental undertakings suffer from the following limitations:

(a) **The Influence of Bureaucracy :** On account of government control, a departmental undertaking suffers from all the ills of bureaucratic functioning. For instance, government permission is required for each expenditure, observance of government decisions regarding appointment and promotion of the employees and so on. Because of these reasons important decisions get delayed, employees cannot be given instant promotion or punishment. On account of these reasons some difficulties come in the way of working of departmental undertakings.

(b) **Excessive Parliamentary Control :** On account of the Parliamentary control difficulties come in the way of day-to-day administration. This is also because questions are repeatedly asked in the parliament about the working of the undertaking.

(c) **Lack of Professional Expertise :** The administrative officers who manage the affairs of the departmental undertakings do not generally have the business experience as well as expertise. Hence, these undertakings are not managed in a professional manner and suffer from deficiency leading to excessive drainage of public funds.

(d) **Lack of Flexibility :** Flexibility is necessary for a successful business so that the demand of the changing times may be fulfilled. But departmental undertakings lack flexibility because its policies cannot be changed instantly.

(e) **Inefficient Functioning :** Such organisations suffer from inefficiency on account of incompetent staff and lack of adequate incentives to improve efficiency of the employees.

It may be noted that departmental form of organisation for public enterprises is on its way to oblivion. Most undertakings such as those providing telephone, electricity services are now being converted into government companies, e.g., MTNL, BSNL, and so on.

Merits	*Limitations*
(a) Fulfillment of social objectives	(a) The Influence of Bureaucracy
(b) Responsibility to the public	(b) Excessive Parliamentary Control
(c) Control Over Economic Activities	(c) Lack of Professional Expertise
(d) Contribution to Government Revenue	(d) Lack of Flexibility
(e) Little Scope for Misuse of Funds	(e) Inefficient Functioning

INTEXT QUESTIONS 7.2

1. List any three services that are being taken care of by Departmental Undertakings.
2. Identify the following and categorise them into Departmental Undertakings, Statutory Corporations and Government Companies.
   (a) Business Organisation established by the government and controlled by the Ministry concerned.
   (b) Organisations incorporated under a special Act of Parliament or state legislature.
   (c) It is managed by the government and is subject to budgetary, accounting and audit control.
   (d) Organisation established by the government and registered under the companies Act.
3. Identify the Merits and Limitations of the departmental undertakings. Put their number in the boxes given below.
   (a) The organisation fulfills the social and economic objectives of the government.
   (b) Lack of flexibility, hence cannot take quick decision.
   (c) The possibility of misuse of funds is limited.
   (d) The organisation suffers due to inefficient and incompetent staff.
   (e) The organisation is responsible to the public through the parliament.

Merits Limitations

We have just discussed Departmental undertakings. Now we shall study about the second category of Public Enterprises, namely Statutory Corporation or Public Corporation.

7.6 STATUTORY CORPORATIONS

The Statutory Corporation (or Public Corporation) refers to such organisations which are incorporated under the special Acts of the Parliament/State Legislative Assemblies. Its management pattern, its powers and functions, the area of activity, rules and regulations for its employees and its relationship with government departments, etc. are specified in the concerned Act. Examples of statutory corporations are State Bank of India, Life Insurance Corporation of India, Industrial Finance Corporation of India, etc. It may be noted that more than one corporation can also be established under the same Act. State Electricity Boards and State Financial Corporation fall in this category.

7.6.1 Features of Statutory Corporations

The main features of Statutory Corporations are as follows:

(a) It is incorporated under a special Act of Parliament or State Legislative Assembly.

(b) It is an autonomous body and is free from government control in respect of its internal management. However, it is accountable to parliament and state legislature.

(c) It has a separate legal existence. Its capital is wholly provided by the government.

(d) It is managed by Board of Directors, which is composed of individuals who are trained and experienced in business management. The members of the board of Directors are nominated by the government.

(e) It is supposed to be self sufficient in financial matters. However, in case of necessity it may take loan and/or seek assistance from the government.

(f) The employees of these enterprises are recruited as per their own requirement by following the terms and conditions of recruitment decided by the Board.

7.6.2 Merits of Statutory Corporations

Statutory Corporation as a form of organisation for public enterprises has certain advantages that can be summarised as follows:

(a) Expert Management : It has the advantages of both the departmental and private undertakings. These enterprises are run on business principles under the guidance of expert and experienced Directors.

(b) Internal Autonomy : Government has no direct interference in the day-to-day management of these corporations. Decisions can be taken promptly without any hindrance.

(c) Responsible to Parliament : Statutory organisations are responsible to Parliament. Their activities are watched by the press and the public. As such they have to maintain a high level of efficiency and accountability.

(d) Flexibility : As these are independent in matters of management and finance, they enjoy adequate flexibility in their operation. This helps in ensuring good performance and operational results.

(e) **Promotion of National Interests :** Statutory Corporations protect and promote national interests. The government is authorised to give policy directions to the statutory corporations under the provisions of the Acts governing them.

(f) **Easy to Raise Funds :** Being government owned statutory bodies, they can easily get the required funds by issuing bonds etc.

7.6.3 Limitations of Statutory Corporations

Having studied the merits of statutory corporations we may now look to its limitations also. The following limitations are observed in statutory corporations.

(a) **Government Interference :** It is true that the greatest advantage of statutory corporation is its independence and flexibility, but it is found only on paper. In reality, there is excessive government interference in most of the matters.

(b) **Rigidity :** The amendments to their activities and rights can be made only by the Parliament. This results in several impediments in business of the corporations to respond to the changing conditions and take bold decisions.

(c) **Ignoring Commercial Approach :** The statutory corporations usually face little competition and lack motivation for good performance. Hence, they suffer from ignorance of commercial principles in managing their affairs.

Merits	*Limitations*
(a) Expert Management	(a) Government Interference
(b) Internal Autonomy	(b) Rigidity
(c) Responsible to Parliament	(c) Ignoring Commercial Approach
(d) Flexibility	
(e) Promotion of National Interest	
(f) Easy to Raise Funds	

INTEXT QUESTIONS 7.3

1. State the features of statutory corporation mentioning its

   (a) Incorporation (b) Management

2. Rectify the errors (if any) in the following sentences and write the correct sentence in the specified space.

   (a) Statutory Corporations are autonomous organisations.

(b) Statutory Corporations are registered under the Companies Act.

(c) Statutory Corporations are motivated by profit.

(d) The internal management of the Statutory Corporations is controlled by the Government.

(e) The capital of Statutory Corporation is provided by private industrialists.

Having studied about Departmental Undertakings and Statutory Corporations we shall now study about Government Companies, which is the modern form of Public Enterprises.

7.7 GOVERNMENT COMPANIES

As per the provisions of the Companies Act, a company in which 51% or more of its capital is held by central and/or state government is regarded as a Government Company. These companies are registered under Companies Act, 1956 and follow all those rules and regulations as are applicable to any other registered company. The Government of India has organised and registered a number of its undertakings as government companies for ensuring managerial autonomy, operational efficiency and provide competition to private sector.

7.7.1 Features of Government Companies

The main features of Government companies are as follows:

(a) It is registered under the Companies Act, 1956.

(b) It has a separate legal entity. It can sue and be sued, and can acquire property in its own name.

(c) The annual reports of the government companies are required to be presented in parliament.

(d) The capital is wholly or partially provided by the government. In case of partially owned company the capital is provided both by the government and private investors. But in such a case the central or state government must own at least 51% shares of the company.

(e) It is managed by the Board of Directors. All the Directors or the majority of Directors are appointed by the government, depending upon the extent of private participation.

(f) Its accounting and audit practices are more like those of private enterprises and its auditors are Chartered Accountants appointed by the government.

(g) Its employees are not civil servants. It regulates its personnel policies according to its articles of associations.

7.7.2 Merits of Government Companies

The merits of government company form of organising a public enterprise are as follows:

(a) **Simple Procedure of Establishment :** A government company, as compared to other public enterprises, can be easily formed as there is no need to get a bill passed by the parliament or state legislature. It can be formed simply by following the procedure laid down by the Companies Act.

(b) **Efficient Working on Business Lines :** The government company can be run on business principles. It is fully independent in financial and administrative matters. Its Board of Directors usually consists of some professionals and independent persons of repute.

(c) **Efficient Management :** As the Annual Report of the government company is placed before both the houses of Parliament for discussion, its management is cautious in carrying out its activities and ensures efficiency in managing the business.

(d) **Healthy Competition :** These companies usually offer a healthy competition to private sector and thus, ensure availability of goods and services at reasonable prices without compromising on the quality.

7.7.3 Limitations of Government Companies

The government companies suffer from the following limitations:

(a) **Lack of Initiative :** The management of government companies always have the fear of public accountability. As a result, they lack initiative in taking right decisions at the right time. Moreover, some directors may not take real interest in business for fear of public criticism.

(b) **Lack of Business Experience :** In practice, the management of these companies is generally put into the hands of administrative service officers who often lack experience in managing the business organisation on professional lines. So, in most cases, they fail to achieve the required efficiency levels.

(c) **Change in Policies and Management :** The policies and management of these companies generally keep on changing with the change of government. Frequent change of rules, policies and procedures leads to an unhealthy situation of the business enterprises.

Merits	*Limitations*
(a) Simple procedure of establishment	(a) Lack of initiative
(b) Efficient working on Business lines	(b) Lack of business experience
(c) Efficient management	(c) Change of policies and management
(d) Healthy competition	

INTEXT QUESTIONS 7.4

1. The main objectives of establishing Government Companies are to ensure:

   (a) Managerial autonomy

   (b) ____________________

   (c) ____________________

2. Classify the following statements as merit or limitation of Government Companies and put the respective numbers in the boxes given below:

   (a) Its formation is simple and it is governed by Companies Act, 1956.

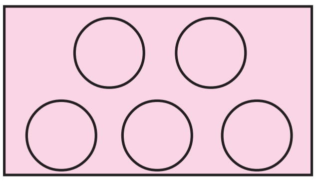
   (b) It creates healthy competition in private sector.

   (c) The Government Companies make delay in taking timely decisions.

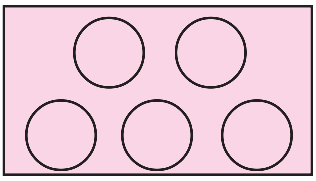
   (d) A change in Government leads to change in rules, policies and procedure of Government Company.

   (e) It has financial and administrative autonomy.

Merits



Limitations



7.8 COMPARATIVE VIEW OF PUBLIC SECTOR ENTERPRISES

S.No.	*Departmental Undertakings*	*Public Corporations*	*Government Companies*
1. Establishment	By a Ministry	By the Parliament under a special Act	By a Ministry with or without private participation
2. Legal Status	No separate entity distinct from the Government	Separate entity to sue and be sued	Separate corporate existence
3. Capital	Provided out of budgetary appropriation	Provided wholly by the Government	Part of it may be provided by private entrepreneurs

Notes

4. Management	Government official from the Ministry concerned	Board of Directors	Board of Directors may include private individuals
5. Control and Accountability	Control vests with the Minister and the Ministry concerned	Parliament	Government (Ministry concerned)
6. Autonomy	No autonomy. Works as a part and parcel of government	No governmental interference in day-to-day affairs	Some freedom from governmental interference
7. Suitability	Defence, public utilities	Heavy industries and service providing enterprises with long gestation period.	All types of industrial and commercial enterprises

7.9 IMPORTANCE OF PUBLIC SECTOR ENTERPRISES

You know that all enterprises in our country are not public enterprises. There is mixed economy in our country and the private as well as the public sector contribute to the development of our economy. However, there are only some selected areas in which the government establishes its enterprises for a balanced development of the economy and promote public welfare. There are several areas where huge investment of capital is necessary but the margin of profit is either meager or it can be obtained only after a long period as in case of generation and supply of electricity, machine building, construction of dams, etc. The private businessmen hesitate to establish their enterprises in these areas but they cannot be neglected in public interest. As such these enterprises are established and run by the government. Similarly the public enterprises also help in balanced regional development by promoting industries in every part of the country. For example, with the establishment of Bhilai Steel Plant in Madhya Pradesh, several new small industries have come up in that state.

Industrial progress is of utmost importance for the development of the country and for this, it is necessary that some basic industries like oil, coal, gas, iron, steel, production of heavy electrical goods, etc., are to be fully developed. Public enterprises give impetus to the development of these basic industries and also help in the development of the private sector with their products and services. There are some industries which require heavy capital investment on account of technical reasons. Electricity, power, production of gas, heavy machinery tools, production of telephone etc., are such industries.

The development of public enterprises also prevents concentration of economic power in the hands of an individual, or a group of individuals. Not only that, in our country economic inequalities are increasing. Poor are becoming poorer and the rich more rich. The public enterprises can help in reducing inequalities with the help of various policies like utilising the earned profits in public welfare activities and by selling raw material to the small scale industries at lower prices.

It is also necessary for the economic progress of the country that industries which can decrease imports and increase exports are only promoted. Public enterprises also ensure promotion of such industries.

There is an old belief that the benefits derived from the nature should be made available to all without any distinction. The public enterprises ensure that land, oil, coal, gas, water, electricity and other necessary resources are made available to all at fair prices.

The security of the country is supreme. There should be no compromise in ensuring this. The production of fighter aeroplanes, arms and ammunition etc, connected with the security of the country is put under the domain of Public Enterprises for the purpose. Thus, public welfare, planned economic development of the country, regional balance, import substitution and checking concentration of economic powers are the major goals achieved through public enterprises.

7.10 CURRENT SCENARIO

Public sector enterprises occupy an important place in the Indian economy. At the time of independence, the Indian economy was basically agrarian with a weak industrial base. There were very few public sector enterprises in our country. The Indian Railways, the Posts and Telegraphs, the Port Trust, Government Salt Factories were the prominent public sector enterprises. After getting independence, the government felt that if the country needs to speed up its economic growth, then state's intervention in all sectors of the economy is inevitable.

At the commencement of the first five-year plan (1.4.1951) Government's investment was Rs. 29 crores in five central public sector enterprises. Now it has increased to Rs. 3,93,057 crores in 239 enterprises as on 31 March 2006. The public sector enterprises have been making substantial contribution to augment the resource of central government. During 2004-05 their contribution to the central exchequer was Rs. 1,10,599 crores.

There is no doubt that public enterprises have played a significant role in the Indian economy. But the overall performance of most of the public sector enterprises is not satisfactory. The rate of return on capital investment is very low. Most of them suffer from the limitations already discussed in the earlier sections. To improve the performance of the public enterprise, Government of India has taken several measures. On 24 July 1991 the Government of India announced its Industrial policy to improve the performance and portfolio of public sector enterprises. The new economic policies also emphasised on liberalisation, privatisation and globalisation of Indian economy. The role of public sector was redefined. In July 1997, Government identified nine central public sector enterprises as 'Navaratnas'. They are BHEL, BPCL, GAIL, HPCL, IOC, MTNL, NTPC, ONGC, SAIL. These public sector enterprises have been given autonomy for capital investment, to enter into joint ventures, to raise capital from domestic and international market etc. In October 1997, the Government granted enhanced autonomy and delegation of financial power to some other profit making public sector enterprises and categorised them as 'Miniratnas'. Presently there are 45 Miniratna Public Sector Enterprises functioning in India.

The Government has taken every step to revive and restructure the public sector enterprises to improve their performance, productivity and profitability. Major emphasis has been laid on the sick and chronically loss making enterprises, which are capable of being revived. These enterprises are referred to Board for Industrial and Financial Reconstruction (BIFR) to prepare appropriate revival or rehabilitation package. The government has set up a Board for Reconstruction of Public Sector Enterprises (BRPSE), which considers and advises the Government on the proposal of restructuring/ revival of sick and loss making units including the proposal for disinvestment or closure or sale. BRPSE has made recommendations in respect of 31 central public sector enterprises so far and out of them the Government has approved revival plan of 15 cases till 30 March 2006.

INTEXT QUESTIONS 7.5

1. Enumerate the major goals achieved through public sector enterprises.

   (a) ______________________________

   (b) ______________________________

   (c) ______________________________

   (d) ______________________________

   (e) ______________________________

2. (a) Expand the following:

(i) BHEL	(ii) BPCL	(iii) GAIL
(iv) HPCL	(v) IOC	(vi) MTNL
(vii) NTPC	(viii) ONGC	(ix) SAIL

   (b) Under which category are all the above public sector enterprises placed by the Central Government.

WHAT YOU HAVE LEARNT

- Business units owned, managed and controlled by the central, state or local government are termed as public sector enterprises or public enterprises. These are also known as public sector undertakings.
- Characteristics of Public Enterprises
  - Owned, managed and controlled by Government.
  - Funded by Government
  - Welfare oriented
  - Concentrate on public utility services
  - Responsible to parliament
  - Observance of Government formality is necessary
- There are three different forms of organisation used for the public sector enterprises. These are (1) Departmental Undertaking; (2) Statutory (or Public) Corporation and (3) Government Company.
- Departmental undertakings are organised, managed and financed by the Government. It is a part of the government and is managed like any other government department. It is financed through the government funds. It is subject to budgetary, accounting and audit control. So the possibility of misuse of funds is reduced. It fulfills the social and economic objectives of the government and is responsible to the legislature. It helps the government to exercise control over the specialised economic activities. Departmental undertakings suffer from limitations of bureaucratic functioning. Excessive parliamentary control, lack of flexibility, inefficient functioning are the other limitations of Departmental Undertakings.
- The Statutory Corporations are the organisations, which are incorporated under the special Acts of the Parliament/State Legislative Assemblies. These are autonomous bodies and are free from government control in respect of their internal management. However, they are accountable to parliament and state legislature. The capital is wholly provided by the government. They are managed by Board of Directors, which is composed of individuals who are trained and experienced in business management. The members of the board of Directors are nominated by the government.
- It is true that the greatest advantage of statutory corporation is its independence and flexibility, but it is found only on paper. In reality, there is excessive government interference in most of the matters. The amendments to their activities and rights

can be made only by the Parliament. Since all these organisations face little competition, sometimes they ignore the commercial approach in managing their affairs.

- A company in which 51% or more of its capital is held by central and/or state government is regarded as a Government Company. These companies are registered under Companies Act 1956 and follow all those rules and regulations as are applicable to any other registered company. The capital is wholly or partially provided by the government. The Government Companies are formed simply by following the procedure laid down by the Companies Act. These companies are managed by the Board of Directors consisting of professionals and independent persons of repute. The government company can be run on business principles and it provides a healthy competition to private sector. Inspite of all these advantages, these companies suffer from the limitations like lack of initiative in taking right decisions at the right time, lack of expertise in business management, frequent change of policies and management due to change in Government, etc.

- Importance of Public Sector Enterprises
  - Balanced regional development
  - Boost the basic industries of an economy
  - Concentrate on public welfare activities
  - Promote export
  - Price control of essential goods
  - Limit the influence of private monopoly.
  - Ensure security of the country.
  - Minimise economic inequalities.

- Current Scenario: At the commencement of first five-year plan Government's investment was Rs. 29 crores in five central public sector enterprises. Now it has increased to Rs. 3,93,057 crores in 239 enterprises as on 31 March 2006. The public enterprises have played a significant role in Indian economy. But the overall performance of most of the public sector enterprises is not satisfactory. The government is taking every step to revive and restructure the public sector enterprises to improve their performance, productivity and profitability. Major emphasis has been given on the sick and chronically loss making enterprises, which are capable of being revived. On 24 July 1991 the Government of India announced its Industrial policy to improve the performance and portfolio of public sector enterprises. The new economic policies also emphasised on liberalisation, privatisation and globalisation. The role of public sector was redefined. To grant autonomy and delegation of financial power to some of the profit making public sector enterprises Government has given them the status of Navaratnas and Miniratnas.

KEY TERMS

Departmental Undertaking	Private sector	Public sector
Government Companies	Public Enterprises	Statutory Corporation

TERMINAL EXERCISE

Very Short Answer Type Questions

1. Define Public Sector Enterprise.
2. What is meant by Public Corporation?
3. State the meaning of Departmental Undertaking.
4. What is a Government Company?
5. Name any two important goals to be achieved through public enterprises.

Short Answer Type Questions

6. Give any four features of Departmental Undertakings.
7. Distinguish between private sector and public sector enterprises (by giving any two points of distinction).
8. Explain (a) Fulfillment of social objectives and (b) Control over economic activities as merits of Departmental Undertakings.
9. How do public enterprises helps in reducing the economic inequalities in the country?
10. Explain any two limitations of Statutory Corporations.

Long Answer Type Questions

11. What is meant by public sector enterprises? State in brief its features?
12. How are the public sector enterprises helping in the balanced development of the Indian Economy and promoting public welfare in the country?
13. What is a Government Company? How is it different from Statutory Corporation? Give any five such distinctions.

14. Explain the merits of a Statutory Corporation over a Departmental Undertaking.

15. In a democracy like India, can we eliminate the public sector and give all the rights to the private sector? Give suitable arguments.

16. While traveling on National Highway you noticed a Company named Hindustan Potash Ltd. Your father told you that it is a Government Company. But you were not satisfied. Therefore, your father explained you the features of a Government company to convince you. What are these features?

17. You have heard about various types of Public Sector Enterprises such as Departmental Undertakings, Public Corporations and Government Companies. Taking an example of all three give at least one name and two features of each.

ANSWERS TO INTEXT QUESTIONS

7.1 1. It refers to economic and social activities undertaken by public authorities.

2. (a) False – The objective of public sector enterprises is welfare of the customer.

   (b) False – The public sector enterprises are managed by the Government.

   (c) False – The public sector enterprises concentrate on area of public utility service.

   (d) True

   (e) False – The public enterprises are financed from government funds andsometimes through pubic issues.

7.2 1. (a) Railways (b) Postal Services (c) Broadcasting

2. (a) Departmental undertaking (d) Statutory corporation

   (c) Government company (d) Government company

3. Merits – (a), (c), (e) Limitations – (b), (d)

7.3 1. (a) It is incorporated under a special Act of Parliament or State Legislature.

   (b) It is managed by a Board of Directors which is composed of individuals who are trained and experienced.

2. (a) No change

(b) Statutory corporations are incorporated under special Act of Parliament or state assemblies.

(c) Statutory corporation are not motivated by profit.

(d) The internal management of the statutory corporation is free from government control.

(e) The capital of statutory corporation is provided by the government.

7.4 1. (b) Operational efficiency (c) Competition to private sector

2. Merits – (a), (b), (e) Limitations – (c), (d)

7.5 1. (a) Public welfare (b) Planned economic development of the country

(c) Regional balance (d) Import substitution

(e) Checking concentration of economic power

2. (a)

(i)	BHEL	–	Bharat Heavy Electricals Limited
(ii)	BPCL	–	Bharat Petroleum Corporation Limited
(iii)	GAIL	–	Gas Authority of India Limited
(iv)	HPCL	–	Hindustan Petroleum Corporation Limited
(v)	IOCL	–	Indian Oil Corporation Limited
(vi)	MTNL	–	Mahanagar Telephone Nigam Limited
(vii)	NTPC	–	National Thermal Power Corporation
(viii)	ONGC	–	Oil and Natural Gas Corporation Ltd.
(ix)	SAIL	–	Steel Authority of India Limited

(b) Navaratna

DO AND LEARN

Find out from 10 residents of your locality to get information about which type of organisation they serve and categorise them in Private sector and Public Sector. Prepare a report stating the reasons for placing the respective organisations in different sectors.

ROLE PLAY

1. Suresh and Ramesh are two close friends meeting each other after a long time. You are required to read the following and pick a role for yourself and the other for your friend and give suitable arguments.

   Suresh : Hey, Ramesh! How are you? I am seeing you after a very long time.

   Ramesh : Hello, Suresh! It is good to see you too.

   Suresh : What are you doing presently?

   Ramesh : I am working as an officer in Indian Railway.

   Suresh : That's good. But I am in a Government Company.

Both of them started discussing about their own organisation.

In the light of the merits and limitations of Departmental Undertakings and Government Companies, you are required to continue the conversation with suitable argument.

2. There was a news about the good performance of Public Sector Organisations. That convince you, as a student of Business Studies. You decide to talk to your tutor about this during the PCP classes. You are Rajan and the conversation with you tutor started as follows :

   Rajan : Sir, What is the reason that Govt. Organisations are performing well now a days in comparision to earlier years.

   Tutor : Rajan you are absolutely correct. But do you know, that there are different types of organisation & all of them are not meant for earning profits.

   Rajan : Is it so sir? Can you please tell something more about these organisations.

   Tutor : Sure Rajan & the discussion continues.

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8

SELF EMPLOYMENT

Having learnt about the nature and scope of business, business support services, business environment, modern mode of business, forms of business organisations etc. you may be thinking about earning your livelyhood. At this stage you have to decide whether to take up a job in an organisation or to start your own business. When you accept an employment in any organisation, you have to perform various jobs as per the requirements of your employer and you may get a fixed amount of income as salary. But, instead of seeking a job, you can also opt to do something on your own to earn your livelihood. You may run a small retail shop, tailoring shop, restaurant, bakery and confectionery, beauty saloon, etc. in your locality. In other words, you may get engaged in trading or manufacturing on a small scale or providing some service for a price. Such economic activities are known as self-employment. In this lesson, let us learn more about the career option of self-employment in business.

OBJECTIVES

After studying this lesson, you will be able to:

- define the term ‘self-employment’;
- recognise the characteristics of self-employment;
- explain the importance of self-employment;
- enumerate the avenues of self-employment;
- explain the meaning and characteristics of small business;
- identify the different types of small businesses;
- describe the importance and scope of small business in India;

- state the various policies of the Government for promotion of small business; and
- explain the various institutional support provided to small business in India.

8.1 MEANING OF SELF-EMPLOYMENT

You know that earning is necessary for a living. Your father, mother, brothers, sisters and others may be engaged in different economic activities through which they earn their livelihood. Have you ever observed their activities? What exactly do they do? Possibly some of them may be working for others in factories, shops, agricultural field etc. and get a fixed amount from their employers for the service rendered by them. These persons are engaged in an economic activity which is termed as wage employment or paid employment. But there are many persons who engage themselves in one occupation or some business which they start and manage on their own. They put in their best effort and take all types of risks to pursue their careers successfully. The entire earning of their work goes to them. All of us have seen small grocery shops, tailoring shops, medical stores etc. in our locality. These are owned and managed by a person, with or without the help of some assistants. Their economic activities are termed as self-employment. So when an individual engages in any economic activity and manages it on his own, it is known as self-employment.

From the above discussion we can analyse the characteristics of self-employment.

8.2 CHARACTERISTICS OF SELF-EMPLOYMENT

Following are the characteristics of self-employment:

1. Self-employment involves doing something on one's own to earn one's livelihood.
2. It involves ownership and management of activities by a person although he/she may take the help of one or two persons to assist him/her. Thus, self-employment may provide employment to other persons as well.
3. The earning from self-employment is not fixed. It depends on the income one can earn by producing or buying and selling goods or providing services to others at a price.
4. In self-employment, the owner alone has to take the profit and bear the risk of loss. So, we find a direct link between the effort and reward in self-employment.
5. It requires some amount of capital investment, although it may be small.
6. In self-employment, a person is free to take decisions in respect of running his business profitably and avail of any opportunity that may come up for expansion of his business. It gives complete freedom to work as per one's own will and within the parameters of the prevailing laws.

Thus, self-employment may be defined as, an economic activity which one may perform on his own as a gainful occupation, and this may consist of producing and selling goods, buying and selling goods, or rendering services for a price.

8.3 IMPORTANCE OF SELF-EMPLOYMENT

Career is a way of making one's livelihood. Self-employment is also a career because one may employ oneself in business or in service activities and earn one's livelihood. With growing unemployment and lack of adequate job opportunities, self-employment has become very significant. its importance can be enumerated as follows.

1. **Advantage of Small Business :** Small-scale business has several advantages over large-scale business. It can be easily started, and requires small amount of capital investment. The self-employment involving activities on a small-scale is a good alternative to large scale business which has brought various evils like environmental pollution, development of slums, exploitation of workers, and so on.

2. **Preference over Wage Employment :** In self-employment there is no limit of earnings as is the case with wage employment. In self-employment one can use one's talent for own benefit. The decisions can be taken quickly and conveniently. All these factors act as strong motivators for self-employment to be preferred over wage employment.

3. **Developing the Spirit of Entrepreneurship :** Entrepreneurship involves taking risks because the entrepreneur tries to innovate new products, new methods of production and marketing. Self-employment, on the other hand, involves either no risk or very little risk. But, as soon as the self-employed person starts becoming innovative and takes steps to expand his business, he becomes an entrepreneur. Therefore, self-employment becomes a launching pad for entrepreneurship.

4. **Promotion of Individualised Services :** Self-employment may also take the form of providing individualised services like tailoring, repair work, dispensing of medicines etc. Such services are helpful in providing better consumer satisfaction. These can be easily started and run by individuals.

5. **Scope for Creativity :** It provides opportunity for development of creativity and skills in art and crafts, leading to preservation of the cultural heritage of India. For example, we can see creative ideas reflected in handicrafts, handloom products, etc.

6. **Reducing the Problem of Unemployment :** Self-employment provides opportunities of gainful occupation to those who otherwise remain unemployed. Thus it reduces the problem of unemployment.

7. **A boon to Under-privileged in Respect of Higher Education :** Everyone may not be able to pursue higher education after Secondary or Senior Secondary examination due to one or the other reason. Such persons can start their career as self-employed in occupations that do not require higher education.

It may be noted that self-employment has been given high priority in government policies and programmes. A number of schemes have been initiated all over the country to encourage entrepreneurship and self-employment.

INTEXT QUESTIONS 8.1

1. Define the term 'Self-employment' in your own words.
2. Which of the following examples indicate self-employment? Put a tick mark in the box if your answer is Yes.
   (a) A worker working in a factory.
   (b) A person running his stationery shop.
   (c) A person working as manager in a bank.
   (d) A person running a chemist shop.

8.4 AVENUES OF SELF-EMPLOYMENT

After learning the importance of self-employment you may be motivated to start your own enterprise even if it is on a small scale. But, what are the areas in which you can successfully run your enterprise? Before choosing a suitable career in self-employment you must have some idea about the avenues in which self-employment opportunities are available. Let us categorise the avenues of self-employment into the following broad areas.

1. Trading;
2. Manufacturing;
3. Professionals; and
4. Individualised services.

Let us discuss further about all these areas.

1. **Trading :** You know that trade involves buying and selling of goods and services. With small amount of investment one can start and run a small trading unit. You can think of starting a small grocery or stationery shop in your locality. If you are able to invest more capital and ready to take risk, then wholesale business is a

good option for you. One can also take up some agency business or become a stockist. The real estate business which is booming now-a-days can also be a lucrative alternative.

2. **Manufacturing :** One can start a small industry of manufacturing bricks, or producing bakery items or confectionery. All these businesses require small amount of capital and simple equipment. Farming is another such area in which a person can work all alone or take the help of one or two persons. This is an age-old area of self-employment. Orchards, dairy, poultry, sericulture, fisheries, horticulture, etc. are good examples of avenues of self-employment.

3. **Professionals :** Occupations that require special knowledge and training in a particular field also provide opportunities of self-employment. Lawyers, doctors, chartered accountants, architects and journalists fall in this category. However one has to follow certain code of conduct framed by their association and need specialised knowledge and training.

4. **Individualised Services :** Tailoring, motor repairing, hair cutting, fashion designing, interior decoration etc. are some of the business activities, which provide individualised services to the consumers. These can be easily started and run by individuals. These activities are based on the personal skills of those who perform them. Blacksmiths, carpenters, goldsmiths are all self-employed persons.

You choose the area of your interest to pursue the career in self-employment. If you decide to start a small business of your own, you must have complete knowledge about the line you choose and the scope and importance of small business in our country, including the government policy and institutional support for its promotion. In the next sections, you will learn about these aspects of small business in detail.

8.5 MEANING OF SMALL BUSINESS

When somebody asks you, 'what is a small business', you would say that a business which is:

- small in size,
- requires low capital investment,
- employs small number of workers,
- volume or value of output is low, may be called as small business.

Yes! You are right. The size, capital investment, number of employees, volume of output as well as value of output etc. are the general parameters of measuring a business enterprise.

Notes

We may define a small business as a business which is actively managed by its owners, operating within the local area and relatively small in size. However, the Government of India has considered the fixed capital investment in plant and machinery as the only criteria to define a small industrial unit in our country. Upto the year 1958, an industrial unit in which fixed capital investment was less than Rs. 5 lakh and employing workers of upto 50 if using power, and upto 100 if not using power was considered as a small business. This limit has been changed by the government from time to time. In the year 1960, the employment criterion was dropped. As per the latest changes with effect from 21 December 1999 the investment limit in plant and machinery of small scale sector has been raised upto Rs.10 million (one crore). The plants and machinery may be held on ownership basis, on lease or on hire purchase. The limit of rupees one crore is subject to the condition that the unit is **not** owned, controlled or subsidiary of any other industrial undertaking.

8.6 CHARACTERISTICS OF SMALL BUSINESS

From the above discussion now we can identify the main characteristics of small business as:

(i) A small business is usually owned and managed by one or a few persons.

(ii) The owners take active participation in day-to-day activities of business.

(iii) The participation of owners in the management helps in taking quick decision.

(iv) The area of operation of a small business is limited. It generally caters to the need of the local people.

(v) The small business units are generally labour intensive and thus require less capital investment.

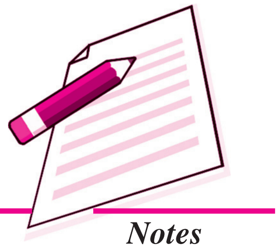
(vi) It generally uses local resources for its operation. The small-scale manufacturing units are usually located near the source of raw material, labour etc.

(vii) Gestation period (the period that a business waits to get return on its investment) is short.

(viii) The operation of a small business is flexible. It can easily change its nature, area of operation, process of production etc. as per the change in social, political and economic conditions.

INTEXT QUESTIONS 8.2

1. State the meaning of small business in your own words. Give your answer in not more than 30 words.



Notes

2. Identify the category (avenue) of self-employment from the following. Mention your answer in the box given against each statement.

   (a) Samnan is a farmer having four acres of land. He has employed three people to look after his fields and orchards.

   (b) Ranjeet runs a small departmental store in the the central market of the city.

   (c) Gopal's mother is a doctor who runs her own clinic.

   (d) Karan's father takes orders and makes furniture.

   (e) Hari repairs gold chains and other ornaments.

8.7 TYPES OF SMALL BUSINESS

In India we find different types of small business. They may be categorised on the basis of investment in fixed capital in plant and machinery or on the basis of nature or place of operation. Following are some of the main types of small business.

(a) Small-scale industries
(b) Tiny industries
(c) Ancillary industrial undertakings
(d) Village industries
(e) Cottage industries
(f) Micro Business enterprises
(g) Small- scale Service and Business (industry related)
(h) Trading units

Let us have a brief idea of these small business.

(a) Small-scale Industries : A small-scale industrial unit is one in which fixed capital investment in plant and machinery does not exceed Rs. One crore. In case of certain export promotion units this investment ceiling can be raised upto Rs. 5 crores.

(b) Tiny Industries : A business unit whose total fixed capital investment in plant and machinery does not exceed Rs. 25 lakhs is called a tiny industry.

(c) Ancillary Industrial Undertakings : When a small-scale industry supplies not less than 50% of its production to another industry, it is called as ancillary industrial undertaking. The fixed capital investment limit of Rs. One crore also applies to it. If an ancillary unit is owned by some other business unit, it losses it status of small business.

(d) Village Industries : A unit that is located in rural area and whose fixed capital investment in plant and machinery does not exceed Rs. 50, 000 per artisan or worker is termed as village industry.

Notes

(e) **Cottage Industries :** These are small manufacturing units producing simple products involving some specific art or skill like handicrafts, filigree etc. They use simple equipments with indigenous technology for production. Cottage industries are carried on wholly or primarily with the help of members of the family either on a whole or part-time basis. These units are not defined by the ceiling of capital of investment.

(f) **Micro Business Enterprises :** The fixed capital investment in plant and machinery of these enterprises does not exceed rupees one lakh.

(g) **Small-scale Service and Business (Industry related) Enterprises (SSSBE):** In these businesses the investment limit in fixed assets of plant and machinery does not exceed Rs. 10 lakhs. The main business enterprises included under this category are – Advertising agency, marketing consultancy, Typing centre, Photo copying centre (Xeroxing), Industrial testing laboratory, Auto repair and garages, laundry and dry cleaning, tailoring, STD/ISD booths, beauty parlor, crèches, etc.

(h) **Trading Units :** These are usually in the form of small retailers found in the market places.

8.8 IMPORTANCE OF SMALL BUSINESS IN INDIA

Having discussed the meaning, characteristics and different types of small business let us now look at its importance. Small business enterprises are found everywhere. They play a major role in the socio-economic development of any country. In view of India's scarce capital resource and abundant labour and natural resources, small-scale enterprises have been given an important place in the economic planning of the country. In India small-scale enterprises account for 35% of the gross value of the output in the manufacturing sector, 80% of the total industrial employment and about 45% of the total exports. Besides these contributions, the importance of small-scale business is increasing day by day due to the following factors.

1. The small business enterprises are capable of generating immediate and large-scale employment opportunities in our country.

2. They require less capital investment as compared to large scale business enterprise.

3. The cost of production is less due to use of local resources and less establishment and running cost.

4. The small industries help in effective mobilisation of the untapped resources of the country. With the help of local resources and indigenous technology, world-class products can be produced by village and cottage industries.

5. Small industries promote balanced regional development of the country. These can be easily set up at the source of resources that leads to overall economic development of that place.

6. The small industries help in improving the national image by exporting quality products to foreign country. The Indian handicrafts, handloom products, filigree, appliqué works have a high demand in international market.

7. Small enterprises help in raising the standard of living of people. The people get employment or can start their own enterprises easily. They get variety of quality products for their daily consumption and use.

8.9 SCOPE FOR SMALL BUSINESS

The scope for small business is vast covering a wide variety of activities starting from retailing to manufacturing. There are some specific areas of economic activity which can be effectively and successfully managed by forming small business enterprises. Let us discuss about the scope for small business.

1. Trading which involves buying and selling of goods and services requires less capital and time to start. This area of economic activity is dominated by small-scale entrepreneurs.

2. The activities which require personalised service like motor repairing, tailoring, carpentry, beauty parlour etc. are run by establishing small business.

3. It is the best option for those who do not like to be an employee, but become self-employed. People can work independently by running a small enterprise of their own.

4. For products and services, which are of less demand or their demand is limited to any specific area, the small-scale business is most suitable for them.

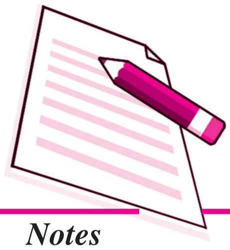
5. A large industrial unit cannot run smoothly without the support of small units. These industrial units often depend upon the small units (ancillary industrial undertaking) to get some parts or spares, which cannot be profitably produced by them.

6. In the era of business process outsourcing (BPO), many new areas have opened up for small business enterprises.

7. The business enterprises, which require constant touch of the owners with customers as well as the employees, can only be successfully run in the form of small enterprises.

INTEXT QUESTIONS 8.3

1. Name any two specific areas of economic activity, which can be effectively managed by small business enterprises.



Notes

2. Identify the type of small scale industries on the basis of fixed capital investment in plant and machinery.

   (a) Total amount of fixed capital investment in plant and machinery does not exceed Rs. 25 lakhs.

   (b) The total amount of fixed capital investment in plant and machinery does not exceed Rs. One lakh.

   (c) The total amount of fixed capital investment in plant and machinery is less than one Crore and more than Rs 25 lakhs.

   (d) The total amount of fixed capital investment in plant and machinery does not exceed Rs. 10 Lakhs.

   (e) The total amount of fixed capital investment in plant and machinery does not exceed Rs. 50,000 per artisan.

8.10 GOVERNMENT POLICY TOWARDS SMALL BUSINESS

The Government of India has given special importance to small business enterprises due to their vast potentiality for development of social and economic conditions of the country. Several kinds of assistance and support are announced from time to time keeping in view the changing economic conditions. The following are some of such steps taken by the Government for development of small business in India.

1. It provides liberalised credit policy like, less formalities to process the loans and advances, loans at concessional rate, etc.) for small scale industries.

2. To keep away from the competition with large scale industries, the Government of India has reserved about 800 items for exclusive production by small scale industries.

3. It provides concession and exemption in excise and sales tax to the small scale units. The excise exemption has raised from Rs. 50 lakh to Rs. One crore for small industries.

4. The Government also gives preference to the products of small enterprises while purchasing stationery and other items for its own consumption and use.

5. For promotion, financing and development of small-scale industrial enterprises several institutes like Small Industrial Development Bank of India (SIDBI), National bank for Agriculture and Rural Development (NABARD), District Industries Centres (DICs) etc. have been set up by the Government.

6. The Government of India has set up separate Ministry of Micro, Small and Medium Enterprises (http://msme.gov.in) for effective planning and monitoring of the development of small business enterprises in the country.

7. To provide benefits of its plans and policies to large number of industries, it has lowered the investment limit from Rs. 3 crore to Rs. One crore.

8. The Government provides capital subsidy of 12 % for investment in technology in select sectors of small-scale business.

9. To encourage total quality management (TQM) the Government provides grant of Rs. 75,000 to each units that obtains ISO 9000 certification.

10. To provide finance, design and marketing support to handloom sector it has launched the Deendayal Hathkargha Protsahan Yojana.

11. The Government of India has permitted upto 24 % of total shareholding of small-scale units by other industrial units.

12. The Government provides land, power and water etc. at concessional rates to small business enterprises.

13. Special incentives are also provided for setting up of small enterprises in rural and backward areas.

14. The Government encourages to establish small-scale industry by providing developed land and industrial estates.

8.11 INSTITUTIONAL SUPPORT TO SMALL BUSINESS

To start and run a business enterprise one requires various resources and facilities. These may be in the form of technical, financial, marketing or training support. Such support is provided by the Government by establishing different institutions or organisations from time to time. Let us now learn about some of such institutions and their role in providing support.

1. **National Small Industries Corporation Ltd. :** The National Small Industries Corporation Ltd. (NSIC) was set up in the year 1955 to promote, aid and foster the growth of small industries in India. It provides wide range of promotional services to small-scale industries. It provides machinery to small-scale industries under hire purchase schemes and also on lease basis. It helps in export marketing of the products of small-scale industries. It also helps in development and upgradation of technology and implementation of modernisation programme of small-scale industries.

2. **State Small Industries Development Corporations :** The State Small Industries Development Corporations (SSIDCs) are set up in various states of our country to cater to the developmental needs of small, tiny and village industries. Their main functions include procurement and distribution of scarce raw materials, supply of machinery on hire purchase basis, and providing marketing facilities for the products of small-scale industries.

Notes

3. **National Bank for Agriculture and Rural Development :** The National Bank for Agriculture and Rural Development (NABARD) was set up in 1982 as an apex institution for financing agricultural and rural sectors. It provides financial assistance through Regional Rural banks and cooperative banks to agriculture, small-scale, cottage and village industries, handicrafts and other allied activities in rural areas.

4. **Small Industries Development Bank of India :** The Small Industries Development Bank of India (SIDBI) was set up in 1990 as a principal financial institution for promotion, financing and development of small-scale industrial enterprises. It acts as an apex institution for all banks providing credit facility to small-scale industries in our country.

5. **Small Industries Service Institutions :** The Small Industries Service Institutions (SISIs) are set up to provide consultancy and training to small enterprises. These institutions render technical support service and conduct entrepreneurship development programmes. They also provide trade and market information to small-scale industries.

6. **District Industries Centres :** For promotion of small industries in our country District Industries Centres (DICs) are set up at district level. They conduct industrial potential survey keeping in view the availability of resources. Their main function includes implementation of various schemes of central and state governments. They appraise the worthiness of various proposals of the entrepreneurs to establish new units, guide them in choosing suitable machinery, equipment and raw materials.

INTEXT QUESTIONS 8.4

1. Mention any five supports provided by SISIs to small-scale industries.
2. Mention the full form of the following in the space given below.

   (a) DIC (b) SIDBI (c) NABARD

   (d) NSIC (e) SSIDC

WHAT YOU HAVE LEARNT

- Any economic activity which one may perform on his own as a gainful occupation is termed as self-employment. Such an activity may consist of producing and selling goods, buying and selling goods, or rendering services for a price.

- Importance of Self-Employment:
  - Advantage of small business
  - Preference over wage employment
  - Developing the spirit of entrepreneurship
  - Promotion of individualised services
  - Scope for creativity
  - Reducing the problem of unemployment
  - A boon to under-privileged in respect of higher studies
- Avenues of self-employment: Before choosing a suitable career in self-employment one must have an idea about the various avenues like trading, manufacturing, professional occupation and individualised services.
- A business which is small in size, requires less capital investment, employs less number of workers, volume or value of output is less, may be called as Small Business.
- Characteristic of Small Business: It is owned and managed by one or few persons. The owner takes active participation in day to day management. Small businesses are generally labour intensive and require less capital investment. These units use local resources and are established mainly to cater to the needs of local people. The operation of a small business is more flexible and requires smaller gestation period.
- On the basis of fixed capital investment in plant and machinery, small businesses in India are classified as (a) Small-scale industries; (b) Tiny industries; (c) Ancillary small industry; (d) Village industries; (e) Cottage industries; (f) Micro business enterprises; (g) Small- scale service and business (industry related) enterprises; and (h) Trading units.
- Importance of small Business in India: Small scale business contribute about 35% gross value of output in manufacturing sectors, 80% of total industrial employment and 45% of total exports. They generate employment opportunities, require less capital investment, promote balanced regional development, improve standard of living of the people and exports quality products.
- Scope for Small Scale Business: The scope for small scale business is vast covering a variety of areas like trading, personalised services, produce products and service for local area, etc.

- The Government of India provides several assistance and support to small business enterprises. These include: liberalised credit policy, capital subsidy, concession and exemption in excise and sales tax, special support for promotion, financing and development of small-scale industries through SIDBI, NABARD, and DICs. It also provides land, power and water etc. at concessional rate to small business enterprises. It has established separate ministry for the over all development of small industries in our country.
- The Government provides technical, financial, marketing and training support to small business enterprises by establishing various organisations like NSIC, SSIDC, SIDBI, NABARD, SISI and DICs.

KEY TERMS

Ancillary small industry	Cottage industry	Gestation period
Micro business	Self-employment	Small-scale industry
Tiny industry	Village industry	

TERMINAL EXERCISE

Very Short Answer Type Questions

1. What is meant by term 'Self-employment'?
2. State any two characteristics of small business.
3. What is tiny industry?
4. Mention any four types of business enterprises included under Small-scale Service and Business (Industry related) Enterprises.
5. Enumerate any four types of small-scale industries found in India.

Short Answer Type Questions

6. Mention any four characteristics of Self-employment.
7. Explain any two avenues of self-employment.
8. State any four characteristics of small business.
9. Describe the role of SIDBI and SISI in providing support to small business in India.
10. What are the areas in which small-scale business enterprises can be successfully established?

Long Answer Type Questions

11. Explain any four points of significance of self-employment.
12. State and explain any four types of small industries.
13. Describe the various institutional support provided to the small business in India.
14. State any six assistance and support provided by the Government of India for development of small-scale business.
15. Describe the importance of small business in India.
16. **After passing Class 12, Apoorva wants to start her own manufacturing business on a small-scale. Her father has promised her to meet her initial financial requirement. She has advised that there number of a government agencies providing help in various fields and she can approach them. Name such agencies and state the nature of assistance these can provide in starting small businesses.**
17. **Amogh when sees his father, who is working in a reputed company on a high position, coming from office quite late and exhausted Most of the times he is tense because of work, he decides never to go for wage employment and will start his own busines in life. Explain him the various avenues of self employment so that he may start weighing advantages and disadvantages of each one of them.**

ANSWERS TO INTEXT QUESTIONS

8.1 2. Yes – ‘b’ and ‘d’

8.2 2. (a) Manufacturing, (b) Trading, (c) Professional Occupation
(d) Individualised Service, (e) Individualised Service

8.3 1. (a) Trading, (b) Personalised services (or any other)

2. (a) Tiny Industry, (b) Micro Business Enterprises,
(c) Small-scale Industry (d) SSSBE, (e) Village Industry.

8.4 1. (a) Consultancy, (b) Training, (c) Technical support service
(d) Entrepreneurship development programmes
(e) Provides trade and market information

2. (a) District Industries Centre
(b) Small Industries Development Bank of India
(c) National Bank for Agriculture and Rural Development
(d) National Small Industries Corporation
(e) State Small Industries Development Corporations

DO AND LEARN

Survey about 5 to 6 small business units in the nearby area and study in detail regarding the following:

a) Avenue of Self-employment

b) Capital investment

c) Type of Small business

d) Govt. support to these small businesses

e) Problems faced by these units (if any)

ROLE PLAY

Ramesh was a brilliant student but his friend Suresh was not upto the mark. But both of them were very good friends. After completing Secondary course Ramesh went to the nearby city for higher studies. During the vacation when Ramesh came to his village he found Suresh moving here and there and that he has discontinued his studies. He was also looking very tense.

Here is the abstract of their conversation.

Ramesh : What happened to you? You look upset.

Suresh : I have discontinued my studies and now I don't want to be a burden on my parents. I want to earn my livelihood. I have to choose a suitable career.

Ramesh : Why do not you start a small business?

Suresh : Small business! I do not have any idea about it.

Ramesh : Okay. Come with me. I shall tell you about it in detail.

Ramesh explained to Suresh about the meaning, characteristics and scope of small business in our country. He also explained to him about the Government as well as various institutional support provided for development of small business.

Choose a role for yourself and one for your friend and continue the conversation.

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9

GETTING READY FOR WAGE EMPLOYMENT

Once you decide to earn your livelihood by pursuing wage employment you should be ready to work as an employee; work under certain terms and conditions of employment; and get fixed amount of salary or wages as remuneration. But how will you enter into the world of employment? In the present employment situation of our country it is not an easy task to get into any job. It requires serious preparation in addition to having required qualification and experience for any job. You need to find out the vacant position of the jobs in different organisations, prepare and post your resume for the same and be ready to face the employment test. In this lesson you will learn in detail about all these points.

OBJECTIVES

After studying this lesson, you will be able to:

- identify the various sources of information about job vacancies;
- explain the meaning and role of employment exchange;
- state the procedure for getting the name registered in employment exchange;
- enumerate the various jobs offered through employment exchange;
- recognise the role of placement agencies in getting the jobs;
- describe the role of advertising media as source of information about the jobs;
- prepare a good bio-data/resume to offer your candidature for any post; and
- prepare yourself for any type of selection test or interview.

Notes

9.1 SOURCES OF INFORMATION ABOUT JOB VACANCIES

You must know some people who are employed in different factories, other business units, and offices. If you ask them as to how did they get the information about the vacancies in those offices, you will learn that they got the necessary information from various sources like:

1.	Employment Exchanges	2.	Placement Agencies
3.	Newspapers and Magazines	4.	Employment News
5.	Internet	6.	Leaflets
7.	Notice boards of the Offices and Factories		
8.	Television and Radio	9.	Mobile Phone
10.	Friends and Relatives		

Let us have a brief idea about all these sources.

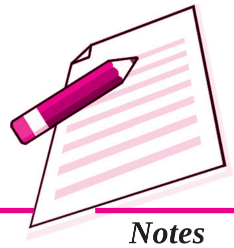
1. **Employment Exchanges :** In our country employment exchanges have been set up by the government for bringing together job seekers and job-providers. The employment exchange maintains the list of job seekers and registers their names for different categories of jobs according to their qualification. When the employers approach the employment exchange for recruitment, it identifies the candidates from its list and informs them about these vacancies so that they can approach the concerned employers.

2. **Placement Agencies :** These are privately operated organisations whose main function is to introduce the job seekers to their prospective employers. Their role is similar to the government owned employment exchanges.

3. **Newspaper and Magazines :** The use of newspapers and magazines both at regional and national level, are the most commonly used mode of information for the candidates about the job vacancies. The employers usually advertise their vacancies and invite the prospective candidates to offer their candidature.

4. **Employment News :** The employment news/Rozgar Samachar is published by Ministry of Information and Broadcasting, Government of India in every week that contains the advertisement of vacancy position of jobs in different organisations. This is simultaneously published in English, Hindi and Urdu languages.

5. **Internet :** Internet is the most convenient source of getting information about the availability of vacancies. A number of organisations, now-a-days give offer through their websites to fill up the vacancies in their offices. By using internet one can search for various job vacancies as per his/her qualification and experience.



Notes

6. **Leaflets :** In cities and towns advertisement for recruitment are sometimes given in leaflets and distributed through newspaper venders. This is particularly suitable where the employer wants to engage the local people for specific jobs only.

7. **Notice Boards of Offices and Factories :** Information about various job vacancies are also displayed on the notice boards of government and private offices and near the factory gates.

8. **Television and Radio :** Sometimes informations about job vacancies are also telecasted through television. It may appear in special programmes or in the form of written message being scrolled during news and other programmes. The cable television operators also give advertisement in the local areas. The advertisements for job vacancies are broadcasted through radio, which is regaining its popularity now-a-days.

9. **Mobile Phone :** Information about job vacancies are sometimes received through mobile phone in the form of SMS. On receiving the message one may show interest to offer his/her candidature. Further information can also be obtained by following the instructions given in the SMS.

10. **Friends and Relatives :** Many times we also get information from our Friends and Relatives about the job vacancies in government, private and business enterprises. The existing staff of the offices may also inform others about the existing vacancies.

9.2 ROLE OF EMPLOYMENT EXCHANGES

The primary objective of Employment Exchanges is settlement of job seekers either through regular jobs or through self-employment. To achieve this objective the employment exchanges in India perform the following functions:

(a) Registration and placement of job seekers so as to ensure a proper balance between demand and supply of labour;

(b) Collect comprehensive Employment Market Information on a quarterly basis for creation of data base for use in effective management of the demand and supply of labour,

(c) Undertake career counselling and vocational guidance with a view to effectively guiding the job seekers.

(d) Conduct area specific specialised study or surveys to have an assessment of skills available and the marketable skills required for encouraging the job seekers for self-employment particularly in rural informal sector.

(e) Arrange disbursement of unemployment allowance to certain specific categories of job seekers through the employment exchanges as decided by some of the State Governments.

There are more than 940 Employment Exchanges run by the State Governments to provide support to the job seekers. These include State Employment Exchange (S.E.E) District Employment Exchange (DEE), Rural Employment Bureau (REB), University Employment Information and Guidance Bureau (UEI &GB) etc. The Employment exchanges are controlled by Directorate General of Employment and Training (DGE&T).

9.2.1 Procedure of Registration

The procedure of getting one's name registered with the employment exchange is as given below: -

1. A candidate can visit any Employment Exchange during specified hours on any working day. He can get from the employment exchange a blank form/ card for registration to be filled up. This card includes entries for the name, father's name, residential address, qualifications, whether general or SC/ST category, N.C.O. Code No., job desired, place where the candidate wishes to serve, salary expected, work experience and other related information.
2. Certain documents have to be enclosed with the card, such as proof of age, photocopies of educational qualification, experience, as well as a photocopy of Proof of residence like driving license, Voter's identity Card, PAN card number, passport or ration card. The candidates are required to bring all certificates/ documents in original and a set of photocopies of all the above documents. The photocopies are retained at the Employment Exchange.
3. Having filled up the card, and with the enclosures ready, you are to see the Employment Officer with your original certificates and copies. He will verify and attest the copies and your signature on the Card and return the original certificates.
4. The card as attested above will be kept in the Employment Exchange for record and making future calls for employment, and a registration card, bearing code no. of the job (NCO), date of registration, and your specimen signatures will be handed over to you. This registration card is to be renewed after every three years. In case of any correspondence with the employment exchange you are to mention your registration number.

It may be mentioned here that in the present employment scenario, the role of Employment Exchanges are not significant. A large number of recruiting agencies like Staff Selection Commission, Railway Recruitment Boards, Banking Service Recruitment Boards etc. have come up and they have restricted the area of operations of the Employment Exchanges. In fact today almost all the major establishments both in Government and outside have their own recruitment agencies. The judgments of the Supreme Court have made it obligatory on the part of the employers to advertise the vacancies in other media and consider candidates not only submitted by the employment exchanges but also those responding to the open advertisements for selection of candidates. Therefore, Employment Exchanges are left with limited categories that too at the lower levels of appointment.

9.2.2 Kinds of Jobs Available through Employment Exchanges

The Employment Exchanges sponsor the names of registered applicants for different types of jobs. The list of some of such jobs/posts for which the Employment Exchanges generally sponsor the names is as follows:

Aya
Barber
Booking Clerk
Caretaker
Carpenter
Data Entry operator
Doctors
Electrician
Instructor (Steno / Steno typist)
Journalist
Laboratory Assistant
Laboratory Attendant
Laboratory Technician
Librarian
Library Attendant/Assistant
Lift operator
Mali
Messenger
Typist
X-Ray Technician

Meter Reader
Motor Mechanic
Nurses
Office Assistant
Operation Theatre Technician
Peon
Pharmacist
Physiotherapist
Plumber
Programmer (Computer Software)
Receptionist
Safai Karamchari
Sales representative
Sanitary Inspector
Security Guards
Stenographer
Teachers (Aided and Primary schools)
Telephone Operator
Travel Agent
Translator

INTEXT QUESTIONS 9.1

1. Which source of information about job vacancy you find convenient and why?
2. Mention any three functions of Employment Exchanges.

9.3 ROLE OF PLACEMENT AGENCIES

The Placement Agencies could be Private Employment Agencies or Management Consultants. Private Employment Agencies bring together the employers and suitable candidates available for a job. Private agencies advertise the vacancies in the

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newspapers, periodicals and Internet. They prepare the data bank of all the prospective employers and job seekers. This data bank helps them to find out the suitable employer for a job seeker and vice versa. They keep on informing the job seekers periodically about the employers and the availability of jobs according to their qualifications, skills and experience. Some placement agencies also help the candidates in preparing their bio-data and other documents.

The placement agencies also screen the applicants against the requirements specified by the employer. They supply a list of candidates, and the organisation only conducts the final round of interview. These agencies function primarily in the Metropolitan cities and they charge a fee from the employer as well as employee for their services. Fake placement agencies are also found in different parts of the country. These fake agencies collect money from the jobseekers and arrange fake interviews. Job seekers, therefore may be careful in utilizing their services.

Management Consultants specialize in the placement of executives at middle and top level of management. These are basically executive searching agencies. These agencies work at a nation wide level and they charge a substantial amount of fee from employer as well as employee. Some of the nationally known Management Consultants are ABC Consultants, Ferguson Associates, The Search House and Analytic Consultancy Bureau.

The placement agencies basically help in informing the availability of jobs in private sectors. Most of the small and medium size business enterprises rely upon the placement agencies for all types of manpower requirement. The big enterprises often advertise the vacancies directly through newspapers and internet. The job seekers can register their name with the placement agencies for the post of office assistant, typist, salesperson, marketing executives, accounts assistant, computer operators etc.

9.4 ROLE OF ADVERTISING MEDIA

You learnt about the role of Employment Exchanges and Placement Agencies in helping the job seekers to get the job of their liking. The advertising media also play an important role in informing the job seekers about the job vacancies and procedure to be followed in applying for the same. You know that advertisements for the job vacancies can be given in print media and electronic media. Print media includes daily Newspapers, Employment News, Journals and Magazines etc. Similarly electronic media mainly includes Internet, Television and Radio.

9.4.1 Print Media

Newspapers are the most common print medium for advertisements of job vacancies. All small and big companies advertise their job vacancies in popular newspapers both at regional level and national level. The Employment News is a weekly publication that only carries advertisements for job vacancies. Some of the popular newspapers carry their employment news editions on weekly basis.

The advertisement for job vacancies in print form receives tremendous response from the job seekers because it contains details about the eligibility criteria, proforma of application form, necessary instruction to fill up the application form etc.

9.4.2 Electronic Media

With the advancement of Information and Communication Technology, electronic media has become the most common and convenient source of recruitment. There are so many websites that provide information about employment opportunities. Some of such sites are www.naukri.com, www.monsterindia.com, www.careerindia.com, www.placementindia.com. They provide the facility of searching various jobs as per:

- the category (like computer, academic, engineering, sales and marketing, finance etc.)
- the required post (fitter, electrical, office assistant, teachers etc.)
- the place of job (i.e. the city or state within which the job seeker wants to search job)
- the experience(number of years of experience)
- expected salary (annual package from 2 to 3 lakhs, 3 to 5 lakhs, 5 to 10 lakhs etc.)

The job seekers can find out the information about various types of job on the basis of the above criteria just by visiting the websites of different placement agencies. The job seekers can also post their resume to these placement agencies to find out suitable job for them. They get information about the availability of jobs as per their qualification and experience through email and accordingly take the action to contact the employers for interview. The employers can also use those resumes and directly contact the job seekers as per their requirement.

INTEXT QUESTIONS 9.2

1. List any three functions of placement agencies.
2. List the criteria on the basis of which one can search the job vacancies through internet.

9.5 APPLYING FOR A JOB

In the earlier sections of this lesson you have learnt the various sources from where you could get the information about the availability of job vacancies, qualification and experience required and details about the employer. Now suppose for a particular post you would like to offer your candidature. What would you do? Obviously you have to prepare an application containing your qualification and experience and other details to justify yourself as the most suitable candidate for that post. This brief account of one's professional or work experience and qualifications is termed as the Bio-data (Biographic Data) or Resume, Curriculum Vitae (CV).

9.5.1 Preparation of a Bio-data

Let us learn how to prepare a Bio-data. In most of the cases the employers want to receive the application in their prescribed proforma that makes their job easier in screening the applications. In that case you need not to be worried about preparing your own bio-data in different style to attract the attention of the employer. But in other cases, mostly for jobs in private sector you should pay special attention to the style, language, presentation as well as contents of your bio-data. Your bio-data should contain factual details. Avoid preparing lengthy bio-data. Briefly present your qualifications, responsibilities, experience and achievements etc.

Your bio-data should have four basic sections. The first being your name and contact details, the second your educational qualifications (academics and technical), then your work history (responsibilities, experience and achievements etc.) and finally details regarding references. The list enclosures may be given at the end of your bio-data. In brief, your bio data should have the following points: -

1. Full Name (in Block Letters)
2. Father's/Husband's Name
3. Date of Birth
4. Residential Address
5. Details of Educational Qualifications
6. Details of Technical or Professional Qualifications, if any
7. Experience
8. Name of References
9. List of Enclosures
10. Signature of Candidate

The above points may be presented in different format and style. Now-a-days the employer wants to scan a bio-data quickly rather than reading page after page about your qualifications and achievements. Therefore, be brief and clear with just enough details to convey your message. A brief guide to help you to arrange the above-mentioned details in a proper order is as follows.

1. Begin your resume with your name, address, phone number, and email address, generally centered on the page.
2. Describe the type of position you are seeking in a sentence or two under a heading labeled 'Objective'.
3. Now, give your educational details - the name of the school, college, institute, board, percentage of marks secured, year of passing the examinations etc. in summary form.
4. Details of any technical education or skills you have may be mentioned. It may include other information about any such skills or experience like computer skills, additional training, foreign language or any other professional association you may belong to.
5. Work experience with job description and responsibilities handled should be described.
6. Personal details like marital status, date of birth, Father's/Husband's name or family details, hobbies and interest can be given under separate heading as 'Personal Details'.

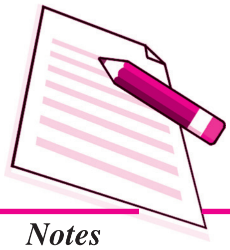
9.5.2 Covering Letter

When applying for a job, the bio-data should be accompanied with an appropriate covering letter. You must be thinking how to write a covering letter. In this section let us learn about different aspects of writing a covering letter.

(a) **The Opening :** This is where you tell the employers 'who you are', 'why are you writing' and 'how you came to know about the vacancy'! The 'who are you' part is a brief introduction of yourself. Just mention the basic facts about you. In the 'why you are writing' part you mention which position you are applying for. Then be sure to mention how you heard about the organization or the job. You might write "This is with reference to your advertisement in Hindustan Times dated 29 January 2014 regarding the vacancy of a trainee in your sales department".

(b) **Suitability of Your Candidature :** The objective of this part of the letter is to mention the reason why the employer should see you as a viable candidate. It is best to start with a statement that provides an overview of your qualifications and emphasizing that they match their requirements. A typical sentence may be "As a trained Graduate in Management I offer the following skills and accomplishment".

(c) **About the Organisation :** In this section of the letter you may tell something positive about the organisation and mention why you would like to be a part of them by working there. You might mention the reputation of the organization, past record, sales records, size, corporate culture, management or anything that they



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take pride in. Prospective employers like to know that you have chosen them for a reason and they are not just one of hundreds of the companies you are applying to.

(d) **Request for further Action :** This is the closing paragraph of the letter. The closing paragraph is about thanking the employer for spending time to read your letter or for considering you as a candidate for a job. It is an important thing to end the letter in a courteous way by taking the initiative to follow up.

Finally check your letter for typographic, misspellings and grammatical errors. Now you are ready for 'complimentary close'. Do not forget to put your signature at the end of your letter.

9.5.3 Some Do's and Don'ts When Applying for a Job

So you have just seen that applying for a job means all about having your bio data and covering letter as the best sales documents about you. The following list of do's and don'ts will help you in preparing your application in a better way.

(a) Follow all the instructions given in the advertisement. If it says send three photographs or three copies of resume, do send as asked! The employer may have his own reasons to ask you to do that.

(b) Make sure your application is sent and received on time. Many companies do not even acknowledge late applications as they reflect on the poor time management skills of the applicants.

(c) Do include all documents in one application. Make sure all your documents are in order and tied up properly with your covering letter on top.

(d) Don't use the same covering letter every time you apply for a job. Write a fresh covering letter every time you apply by making changes appropriate for the vacancy you are applying for. Do not customise it.

(e) Don't assume that your application has been received. Confirm from the employer or the placement agency if they have received your application. Applications may be misplaced in post even e-mail should be confirmed.

(f) Don't include written references in your application. Include them only if asked for.

(g) Try to get all the facts before applying for a job and tailor your application accordingly.

(h) If your application is not considered then do find out the reason. Learn from it. Knowing your weaknesses will help you to improve while applying second time.

INTEXT QUESTIONS 9.3

1. What are the informations one should give in the opening part of the covering letter.

2. Name the different basic sections a bio-data should contain.

9.6 EMPLOYMENT TESTS

The selection test for employment usually held in the form of written test, physical fitness and interview. Let us learn about these tests in brief.

9.6.1 Written Test

Most of the organisations particularly in government sector conduct written test for the selection of candidates. This test may be conducted to test the subject knowledge or general aptitude of the candidates. Descriptive or multiple-choice questions are framed for the written test. To test the general aptitude questions are asked from current affairs, general science, reasoning, arithmetic, languages etc. The job seeker must prepare seriously and make thorough practice for the written test.

9.6.2 Physical Fitness Test

In certain categories of jobs like Defence, Police and Forest services physical fitness of the candidate is essential. So they conduct physical fitness test for selection of right candidate. In almost all cases medical test is also conducted by giving offer for appointment. This test is arranged to know whether the candidate is suffering form any serious disease that might affect the normal functioning of his job.

9.6.3 Interview

To judge the communication skill, presentation skill, subject command, leadership quality, personality etc. the employers usually arrange for interview. This may be done in the form of group discussion and personal interview. For group discussion, small groups are formed to discuss on any specific topic. During the discussion the employer judge the communication and leadership qualities of the candidate. The employer can observe the candidates' performance sitting in the discussion room or through at close circuit television. This process can also be carried out in teleconferencing mode in which the employer can observe the process sitting at distant places even sitting in a foreign country.

In personal interview the prospective employer and employee interact with each other by using different mode. Here the prospective employer tries to evaluate the candidate from different angles like his/her personality, communication skill, subject command, judgment, honesty, integrity, tolerance, patience, politeness, promptness etc. The personal interview can be held in the form of:

(a) Telephonic Interview

(b) Interview through Teleconference

(c) Chatting through Internet

(d) Face to face interaction

Face to face interview is the most common form of personal interview in which the candidate is asked to interact with the interview board. The interview board is headed by a chairperson and comprises of senior officers from the same organisation and outside experts. The other forms of personal interview like telephonic interview, interview through teleconferencing and chatting through internet are common in corporate sector.

9.7 PERSONAL INTERVIEW

The main purpose of holding personal interview is to assess the suitability of the candidate for a particular post. So it is very important for you to prepare for the interview physically, mentally and psychologically. In this section you shall learn about the different aspect of personal interview that would help in to face the interview board comfortably and confidently. Let us discuss those points by classifying the entire procedure into three different stages – (i) Preparing for the interview; (ii) On the day of the interview; and (iii) During the Interview. Let us learn in detail.

(i) Preparing for the Interview

At this stage you are advised to do the following:

1. Keep yourself well informed about current affairs, important current national and international problems and issues, and topics of general interest through regular reading of newspapers and listening to radio and watching the discussions on television.

2. Gather information about the organisation, its main activity, background, expansion / takeover plans etc. All these informations can be obtained from the Annual Report of the organisation or from its website.

3. Know the job profile of the post applied for.

4. Refresh your area of specialisation. A revision of your own subject of studies is desirable.

5. List out your strength and weakness.

6. Visit the site of interview, if possible. Prior visit will help to ensure punctuality on the day of interview and also will reduce nervousness.

7. Put all your documents and certificates including the call letter for the interview in a folder.

(ii) On the Day of the Interview

1. Have a good sleep in the previous night and wake up early in the morning.
2. Do your daily chores.
3. Ensure that your appearance is neat and tidy. Use well-pressed clothes, well-polished footwear.
4. Carry your document folder and reach the interview site on time.
5. After reaching the site go to the washroom, comb your hair and watch your appearance.
6. Then wait at the interview place for your turn.
7. During the waiting time you can even ask for the literature of the company and read it.

(iii) During the Interview

Take care of the following points inside the interview chamber.

1. Entry to the interview room is most important. Knock, greet, and close the door while facing the interviewer as gently as possible. Walk in confidently. Do not sit till you are asked to. If the interviewer gives a hand, give him warm, confident and firm handshake. Remember first impression is very important. In your entry you are being observed for your gait, confidence and manners.
2. The body language of the candidate is observed carefully. Sit properly and bend forward slightly to show an attitude of interest and attention. Do not fiddle with anything - pen, paper, spectacles, other items on table like paperweight etc. Fidgeting, twitching, scratching etc. show lack of confidence and concentration.
3. While answering questions the following points need to be observed.
    - Listen, think and then talk.
    - Do not be in hurry to answer. Take your own time.
    - If you have not heard or understood the question, politely ask for a repeat. Do not assume things and give wrong position.
    - If you do not know the answer, tell frankly that you do not know.
    - If you make a mistake, admit it gracefully.
    - Be brief and clear in your reply. No one likes a talkative person.
    - Do not tell a lie. Be honest in your response.
    - Do not get angry and lose your Control even if the questions are insulting or irrelevant. Remember it may be asked to check your patience or attitude.

- Do not interrupt. Maintain eye contact.
- Avoid words like 'I mean', 'Okay' etc.
- Display enthusiasm, courage and energy while answering the questions. This shows that you are genuinely interested in the job.
- Ask questions if you are asked to ask.
- Be well mannered during the whole interview. Words like 'Thank you' 'I beg your pardon' ' yes please' at appropriate places reflect your manners.
- Be natural. Don't try to copy anyone.
- At the end of the interview, thank the interviewer politely with smile.
- Your picking up things from the table, getting up and leaving the room is also observed. Do these movements confidently.
- Walk confidently. Open the door while facing the interviewer and close the door after you leave.
- Do not forget to wish the receptionist or secretary before you leave the premises.

Analyze the interview to know what went wrong. Accept your failure and get ready for next interview.

Some typical questions asked at an interview	*What do interviewers look for in a candidate?*	*Some common reasons for rejection at an Interview*
• Why do you consider yourself suitable for this job? • Tell me something about yourself or your family background. • What are your strength and weaknesses? • Why do you want to join this company? • Why have you chosen this line/field? • What are your goals in life? • What are your hobbies and how do you spend your free time? • What are your salary expectations?	• Personality • Knowledge of the subject/intelligence • Education and experience • Communication Skills • Past achievements • Personal qualities like honesty, integrity, tolerance, patience, politeness, promptness etc.	• Poor physical projection • Lack of courtesy/manners • Lack of sincerity • Dishonesty • Poor communication skills • Disorganized and vague answers • Telling lies • Non punctuality • Lack of knowledge/ intelligence • Loud voice • Under/over confident • Poor grooming

INTEXT QUESTIONS 9.4

1. Name two terms/phrases a candidate should avoid during an interview.
2. Name three term/phrases one may use during an interview to show his/her good manners.
3. Name the different forms of personal interview

WHAT YOU HAVE LEARNT

- The various sources of information about job vacancies are (a) Employment Exchanges, (b) Placement Agencies, (c) Newspapers and Magazines, (d) Employment News, (e) Internet, (f) Leaflets, (g) Notice boards of the Offices and Factories, (h) Television and Radio, (i) Mobile Phone, and (j) Friends and Relatives.
- Employment Exchange helps the job seekers in registering and sponsoring their names for various job vacancies. It also undertakes career counselling and vocational guidance to the job seekers. It collects comprehensive 'employment market information' on a quarterly basis for creation of data base for use in effective management of the demand and supply of labour. It conducts area specific specialised study or surveys to have an assessment of skills available and the marketable skills required for encouraging the job seekers for self-employment
- The Placement Agencies bring together the employers and suitable candidates available for a job. They advertise the post, prepare the data bank of job seekers and inform them as per the availability of post. Some placement agencies also perform the screening of applications on behalf of the employers. The Management Consultants perform the placement of executives at middle and top level of management.
- The advertising media also play an important role in informing the job seekers about the job vacancies. The advertising media may consist of print media and electronic media. Print media includes daily Newspapers, Employment News, Journals and Magazines etc. Similarly electronic media mainly includes Internet, Television and Radio.
- While applying for a job one should give more attention to prepare a well balanced bio-data. A standard bio-data should have four basic sections – (a) Name and contact details; (b) Educational qualifications (academics and technical); (c) Work history (responsibilities, experience and achievements etc.); and (d) Details regarding references.

- When applying for a job, the bio-data should be accompanied with an appropriate covering letter. This letter contains four parts. The opening part contains the information about candidate, why is he writing and how he came to know about the vacancy. The second part contains the suitability of the candidate for that particular post. The third part highlights the reasons for choosing that organisation to serve there. Finally, the candidate makes a formal request to consider his application and taking suitable action.
- The selection test for employment is usually held in the form of written test, physical fitness and interview. The interview may be taken in the form of group discussion and personal interview. The personal interview may be arranged in the form of (a) Telephonic Interview; (b) Interview through Teleconference; (c) Chatting through Internet; and (d) Face to face interaction.

KEY TERMS

Bio-data	Curriculum Vitae	Employment Exchanges
Employment News	Internet	Interview
Management Consultants	Personal Interview	Physical Fitness Test
Placement Agencies	Resume	

TERMINAL EXERCISE

Very Short Answer Type Questions

1. Enumerate any four sources of information of vacancies of job.
2. State the role of management consultants in the process of recruitment.
3. What is meant by the term 'resume'?
4. Name any four personal qualities of a job seeker.
5. What are the qualities an interviewer can judge from 'Group discussion'?

Short Answer Type Questions

6. Employment Exchanges are not playing significant role in the process of recruitment. Do you agree with this statement? Give reasons.
7. Explain any two sources that provide information about job vacancies.
8. State the functions performed by placement agencies in the process of recruitment.
9. State any four points one should mention in his/her bio-data.

10. Describe the role of print media in providing information about the vacancies in job position.

Long Answer Type Questions

11. Briefly describe the procedure for getting the name registered in employment exchanges.
12. Explain the role of employment exchanges in India.
13. Describe the role of electronic media in helping the job seekers to get the jobs of their liking.
14. What are the points one should consider while preparing a covering letter for sending bio-data to a company?
15. Describe in brief the interview form of selection test.

ANSWERS TO INTEXT QUESTIONS

9.1 2. (a) Registration and placement of job seekers

(b) Career counselling and vocational guidance

(c) Collection of information about employment market

9.2 1. (a) Prepare the data bank of employers and job seekers

(b) Advertise the vacancies

(c) Help the job seekers in preparing their bio-data

2. (a) Category of jobs (b) Post (c) Place of job

(d) Expected salary

9.3 1. (a) Brief introduction of the applicant

(b) Purpose of writing the application

(c) Sources of information about the vacancy

2. (a) Name and contact details (b) Educational qualifications

(c) Work history (d) Details regarding references

9.4 1. (a) I mean (b) Okay

2. (a) Thank you (b) I beg your pardon (c) Yes please

3. (a) Telephonic Interview (b) Interview through Teleconference

(c) Chatting through Internet (d) Face to face interaction

DO AND LEARN

(1) Visit the nearest Employment Exchange and watch the process of registration of name.

(2) Familiarize yourself with the important documents to be filled up to get vocational guidance in Employment Exchange.

(3) Take out one week's newspapers and identify the job vacancies for which you qualify after passing 10+2 examination.

ROLE PLAY

Meena and Reena are two friends. After completing the studies Meena joined in a nationalised bank as an officer and Reena started an export business. Reena did very well in her business at the beginning. But after a period of three years she observed that her business is not yielding good result and finally decided to wind up the business. Both the friends met each other after a gap of five years. They started interacting.

Meena : Hi! Reena. What are you doing now?

Reena : Nothing. I am trying to get into some job. But I am not successful till now.

Meena : What is the problem?

Reena : I don't know. I am doing very well in the written test. But during the personal interview I failed each time.

Meena : Okay, my friend. Don't worry. I will give some tips. Definitely you will be successful next time.

Both the friends started discussing the various points to be considered while preparing for the personal interview.

Assume the role of Meena and ask your friend to play as Reena and continue the conversation.

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FUNDAMENTALS OF MANAGEMENT

Let us take the example of a housewife. She is the person who manages all the household work. She decides upon a number of things like – how to decorate the house in terms of furniture, curtains, bed sheets, sofa covers, crockery, cooking utensils etc.; what type of food is to be served to family members, what shall be the timing of breakfast, lunch, dinner, etc.; and then arranges the requisite materials to prepare the food, hires a maid/servant to assist household work on a part time or full time basis and looks after many other such work. She not only decides all these but ensures that all this work is carried out properly. For this purpose she does some work herself and may distribute certain work among the family members so that work is carried on smoothly. For example, she may assign the task of dropping the children to the school to her husband, the task of clearing the bed to the eldest child, the task of cleaning utensils to the part time maid and so on. Every housewife does all this work in her own way depending upon her understanding, interest and commitment and so also the resources available.

Similarly, take the case of a school teacher who is given the task of taking school children on a picnic. The teacher also decides upon a number of things like – where to go, when to go, how many students and other teacher shall go, how much money is required where to get such money, by what time students must come back, how to collect them from home and drop them and so on. Then he also assigns duties to other persons assisting him in the exercise. For example, he may assign the task to other for arranging a bus for conveyance, collecting money from students, make a group of students to arrange for food and its distribution, and so on. Again, every school teacher if assigned a similar exercise may handle it in his own way depending upon the capability and interest of the teacher as well as a number of other factors.

Let us take another example. There may be many grocery shops in your locality. Consider any two such shops owned by individuals as sole-proprietors. Both of them do a number of activities like procuring goods from manufacturers / wholesalers and selling

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them to consumers, maintaining records of transactions, paying taxes, supervising the staff, and making efforts to improve sales, etc. However, how they handle all these jobs depends upon their capabilities and factors like the location of their store, the assistants they have and so on.

On analysing the above examples we find one thing common among the housewife, the school teacher as well as the grocery owner i.e., they are all involved in managing an important activity namely the household, the school picnic and the business respectively. Thus, we find management everywhere, every housewife manages her household work, every professional manages his tasks and every businessman manages his business. In this lesson we shall learn about the concept of management in the context of managing a business, and its characteristics, nature, importance, functions and the general principles guiding managerial actions in the management process.

OBJECTIVES

After studying this lesson, you will be able to:

- explain the concept of management;
- state the objectives of management;
- identify the characteristics of management;
- explain the importance of management;
- describe management as an activity, as a process, as a profession and as a discipline;
- identify the various levels of management;
- describe the functions of management and
- explain the principles of management.

10.1 MEANING AND OBJECTIVES OF MANAGEMENT

10.1.1 Meaning of Management

Consider a business enterprise, it may be an industry or it may be a trading concern. In both the cases, to start and run the business some amount of money is needed, some materials, few machines and some men are required, and some processes are involved. All these are considered the inputs for a business that result in output in terms of products or services. However, with same amount of money, raw materials, machines and men, and following the same processes, the output may not be same in all cases. For example, with same amount of money, men, machines and materials, if you and Ramesh start a similar business independently, the result may not be the same for both of you. You may do well whereas Ramesh may not. But this is because the inputs do not become output by themselves. Various activities are required and these need to be properly directed, coordinated and integrated so that the inputs produce good results. This process of using various resources (inputs) to produce some results (outputs) is known as management, and the degree of success varies according to the efficiency with which the resources are managed. Thus, management refers to the process of using men, money, machines, material and processes through proper direction, coordination and integration of several activities so as to produce desired results and attain predetermined goals. In other words, management consists of a series of activities classified into various functions like planning, organising, staffing, directing and controlling.

10.1.2 Objectives of Management

Management helps in efficient and effective use of available resources of an organisation. Objectives are the end results, towards which all managerial efforts and organisational activities are directed. Objectives of management include –

1. **Optimum Utilisation of Resources :** Management should try to secure maximum outlay with minimum efforts and resources by utilising the human and material resources available in an organisation for deriving the best results.

2. **Increase in Productivity of All Factors of Production :** Management should minimise the wastage of time, money and efforts through proper utilisation of various factors of production like capital and labour. This will lead to increase in efficiency of all factors of production. It should also try to set higher standards of productions every year and should strive higher to reach these targets.

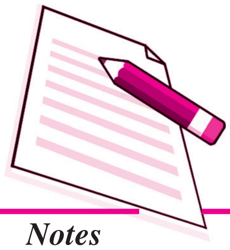
3. **Fair Return on Capital :** Management has to provide a fair return to the owners on the capital invested by them. Management must maintain the investment and should also attract further investments for growth and expansion.

4. **Create Goodwill :** Management should aim at building the reputation of the firm through various activities like popularising products by advertising, reasonable price, good quality products etc. Business environment is dynamic and is influenced by a number of factors.

5. **Meet Challenges of the Changing Environment :** Enterprises which are unable to adopt itself to the changing situations, will not be able to survive. Management should frame steps to meet the challenges of the changing environment. Thus, management can help an organisation for its survival and growth.

10.2 CHARACTERISTICS OF MANAGEMENT

The various characteristics of management are:



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(a) **Management is Universal :** It means that management is required for every type of organisation. It may be a business organisation or social or political. It may be a small firm or a large one. Management is required by a school or a college or university or a hospital or a big firm like Reliance Industries Limited or a small variety store in your locality. Thus, it is a universal phenomenon and is common and essential element in all organisations.

(b) **Management is Goal Directed :** Every organisation is created to achieve certain goals. For example, for a business firm it may be to make maximum profit and/or to provide quality products and services. Management of an organisation is always aimed at achievement of the organisational goals. Success of management is determined by the extent to which these goals are achieved.

(c) **Management is a Continuous Process :** Management is an ongoing process. It continues as long as the organisation exists. No activity can take place without management. To perform all activities like production, sale, storage, operation etc. management is required. So, as long as these activities continue the process of management also continues to operate.

(d) **Management is an Integrating Process :** All the functions, activities, processes and operations are intermixed among themselves. It is the task of management to bring them together and proceed in a coordinated manner to achieve desired result. In fact, without integration of men, machine and material and coordination of individual efforts to contribute successfully as a team, it will be difficult to achieve organisational goals.

(e) **Management is Intangible :** Management is not a place like a graphic showing Board meeting or a graphic showing a school Principal at her office desk which can be seen. It is an unseen force and you can feel its presence in the form of rules, regulation, output, work climate, etc.

(f) **Management is Multi-disciplinary :** Management of an organisation requires wide knowledge about various disciplines as it covers handling of man, machine, material and looking after production, distribution, accounting and many other functions. Thus, we find the principles and techniques of management are mostly drawn from almost all fields of study like – Engineering, Economics, Sociology, Psychology, Anthropology, Mathematics, Statistics etc.

(g) **Management is a Social Process :** The most important aspect of management is handling people organised in work groups. This involves developing and motivating people at work and taking care of their satisfaction as social beings. All managerial actions are primarily concerned with relations between people and so it is treated as a social process.

(h) Management is Situational : The success of management depends on, and varies from, situation to situation. There is no best way of managing. The techniques and principles of management are relative, and do not hold good for all situations to come.

10.3 IMPORTANCE OF MANAGEMENT

The existence and success of any organisation largely depends on the kind of management it has. No amount of quality resources is going to help unless they are put to productive use by efficient management. It is because of this reason that management is studied as a subject in almost every discipline of study. In today's scenario with globalisation, job specialisation, changing technologies, new responsibilities of business, consumerism, competition and emphasis on research and development, the role of management has grown multifold. Its importance is reflected in the positive result that the organisation can get in respect of the following.

(a) Attainment of Goals : Every organisation has a goal to achieve and each employee in the organisation also has his own goals that he wants to achieve. Even at operational level each department, each unit or even each group has a goal that it wants to achieve. It is only through proper management – by well thought of planning, good direction and proper coordination and control that effectiveness to the efforts of each group to achieve given goals can be ensured.

(b) Stability and Growth : Management strives to utilise the available resources of the organisation effectively and efficiently. It controls the activities and operations, integrates the functions, motivates the employees, maintains the health of the organisation in the ever changing environment. It thus, ensures stability to the working of the organisation and contributes to its growth.

(c) Change and Development : Management keeps itself in touch with the changes in the environment and foresees development in the future. Accordingly, plans are made to keep the organisation ready to meet the challenges. The technologies, operations, process as human factors are developed on a continuous basis keeping an eye on the future.

(d) Efficiency and Effectiveness : By proper planning, staffing, organising, coordinating, directing, and its controlling activities, the management helps in achieving efficiency and effectiveness to human efforts and operations.

INTEXT QUESTIONS 10.1

1. Define the term 'Management' in your own words.

2. Complete the following incomplete words by taking clues from the statements given for each. Every blank represents one letter only. First one has been done for you.

   (a) Management is U__ __ V __ __S __ L (UNIVERSAL)

   (b) Management is __ N__ __ __G I __ __ E

   (c) Management is S __ __ I __ L process

   (d) Management is S __ __ U __ __ __ O __ A L

   (e) Management is a __ O __ T I __ __ O __ S process

Clues:

   (a) It is required for every type of organisation.

   (b) It is an unseen force.

   (c) It deals with people organised in groups.

   (d) There is no best way of managing, so it varies.

   (e) It is an ongoing process.

3. List any three objectives of management.

10.4 NATURE OF MANAGEMENT

The nature of management can be better appreciated by looking at it

(a) Management as a Process : Management consists of a series of inter-related activities of planning, organising and controlling. All activities are undertaken in a proper sequence with a systematic approach so as to ensure that all actions are directed towards achievement of common goals. Thus, it is regarded as a process of organising and employing resources to accomplish the predetermined objectives.

(b) Management as a Discipline : Management is a systematised body of knowledge that has developed, grown and evolved over the years through practice and research. The knowledge so cumulated is disseminated to successive generations of managers and used by them in performing their jobs. Thus, it has become a separate field of study with its own principles and practices and thus, evolved as an independent discipline with its own techniques and approaches.

(c) Management as a Group : Management normally refers to a group of managers working in an organisation. It includes the top executive as well as the first line supervisors. These managers perform their functions jointly as a group. The success of business does not depend on the efficiency of one, but of all managers taken together. Managers work as a team so that objectives of the business are fully achieved. However, in every organisation there are certain levels of management with varying degree of the nature of authority and responsibilities. You will learn about these later in this lesson.

(d) Management as a Science as well as an Art : Management is regarded as a science as well as an art. Science refers to a systematic body of knowledge with reference to understanding of some phenomenon or subject or object of study. It establishes a cause and effect relationship between variables. It is based on systematic explanation, experimental analysis, critical evaluation and logical consistency. In science we learn the 'why' of a phenomenon. For example, two molecules/atoms of hydrogen and one molecule/atom of oxygen makes water (H_2O). Similarly we can say earth moves around the sun. Any subject of study is called a science should have the following characteristics:

(i) There must be a systematised body of knowledge that includes concepts, people and theories.

(ii) We should be able to establish a cause and effect relationship.

(iii) Its principles should be verifiable.

(iv) It should ensure predictable results.

(v) It should have universal application.

Management as a subject of study fulfils almost all the above characteristics. Theories and techniques like scientific management, PERT and CPM, break even analysis, budgeting etc. are all scientific in nature. However, since it deals with human beings, we cannot predict a definite cause - effect relationship. Hence management is not treated as a pure or full-fledged science.

As for the art, you know that it refers to bringing about the desired result through application of skill. It is a personalised process and states that there is no best way of doing a thing. Thus, it is creative and it improves by practice. In art we learn about the 'how' of a phenomenon. For example, take the case of painting. There is nothing called the best way of painting. More one paints, the more he improves and learns how to paint. Now look at management. Here also we apply a lot of skill (like technical, conceptual, human etc.) and it is also creative in nature. Nobody can say that this is the best way of managing. It varies from one manager to another. The more one manages, the more experienced and expert he becomes.

Thus, management is a combination of both science and art.

Notes

(e) Management as Profession : In the first lesson you had learnt that profession is an occupation. To be precise, any occupation that satisfies the following requirements is called a profession.

(i) It must be an organised and systematised body of knowledge. Take for example professions like engineering or chartered accountancy. These require a specialised knowledge.

(ii) There is always a formal method of acquisition of such knowledge. In other words, individuals, to pursue a specific profession, must acquire the specialised knowledge through some formal institutions. For example, you need to get a degree in law or engineering to pursue the profession of a lawyer or engineer.

(iii) There exists an association to devise certain code of conduct for the professionals. This code of conduct lays down norms to be observed by the professionals while doing their job. Violation of the prescribed code can lead to derecognising the professional to practise.

(iv) A profession is no doubt an occupation to earn one's livelihood but the financial reward is not the main measure of their success. The professional use their specialised knowledge to serve the long-run interests of the society and are also conscious of their social responsibility.

Though management may not meet all the requirements of a profession in strict sense of the term, but it meets most of the above requirements and is, now a days, regarded a full- fledged profession. A number of institutions have come up to teach management in a formal way and train future managers. Various associations like American Management Association in USA, All India Management Association in India have been functioning as representative bodies of managers and have duly devised codes of conduct for managers. Many more organisations have come up in the specialised fields of management.

INTEXT QUESTIONS 10.2

1. The following statements make the management an art, science or profession. Identify each statement and put their numbers in the box given below.

   (a) There is a systematised body of knowledge that includes concepts, theories and people.

   (b) It is creative in nature

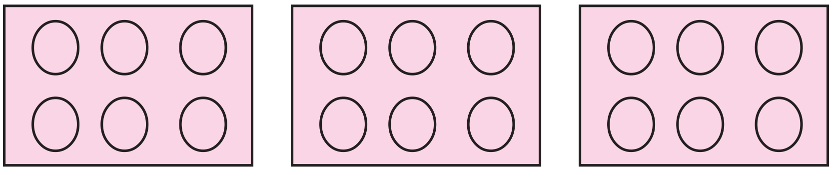
   (c) It should have universal application.

Notes

(d) There is no best way of managing.

(e) There is always a formal method of acquisition of knowledge.

Art Science Profession



2. Match the expression given in Column-I with these given in Column-II.

Column - I	Column - II
(a) Management as a discipline	(i) Team of managers
(b) Management as a process	(ii) Code of conduct for professionals
(c) Management as a group	(iii) Developed and grown through practice and research
(d) Management as a profession	(iv) Series of inter-related activities

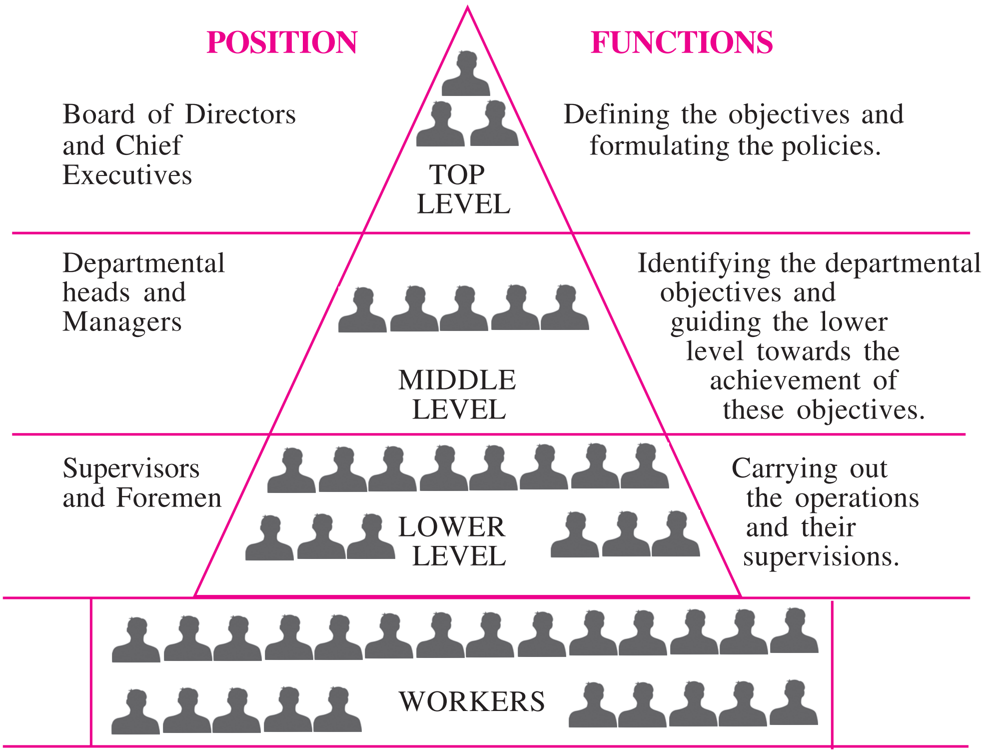
10.5 LEVELS OF MANAGEMENT

As stated earlier, there are certain levels of management with varying degree of authority and responsibilities. Some managers decide about the objectives of the business as a whole; some managers perform functions to achieve these objectives in different departments, like production, sales, etc, and some of the managers are concerned with the supervision of day-to-day activities of workers. Managers performing different types of duties may, thus, be divided into three categories:

- Top-Level Management
- Middle-Level Management
- Lower-Level Management

The diagram shows that the top level management includes Board of Directors and the Chief Executive. The chief executive may have the designation of Chairman, Managing Director, President, Executive Director or General Manager. This level determines the objectives of the business as a whole and lays down policies to achieve these objectives (making of policy means providing guidelines for actions and decision). The top management also exercises an overall control over the organisation.

The following diagram will give you an idea about the functions, positions and relations of different levels of management.



The middle-level management includes heads of various departments, e.g., production, sales, etc., and other departmental managers. Sometimes senior departmental heads are included in the top management team. The objectives of the business as a whole are translated into departmental objectives for the middle level management. The heads of the departments then work out their own strategies so as to achieve these objectives. Middle-level managers are particularly concerned with the activities of their respective departments.

The lower-level management consists of foremen and supervisors who look after the operative workers, and ensure that the work is carried out properly and on time. Thus, they have the primary responsibility for the actual production of goods and services in the organisation.

These three levels of management taken together form the 'hierarchy of management'. It indicates the ranks and positions of managers in the hierarchy. It shows that the middle-level management is subordinate to the top-level and that the lower-level is subordinate to the middle-level management.

Carefully see the figure shown above once again. You will see that the number of people at each level increases as one moves from top to bottom. Workers including crafts persons, manual labourers, engineers, scientists, etc. form the bulk of the organisation membership. Within the managerial ranks, the number of managers at each level decreases as one moves from lower-level to top-level management. At the top of the organisation, there is usually one person.

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10.6 FUNCTIONS OF MANAGEMENT

In every organisation, the managers perform certain basic functions. These are broadly divided into six categories viz., planning, organising, staffing, directing, coordinating and controlling. These are discussed basically hereunder. You will learn about all these functions in detail in the lessons to follow.

(a) **Planning :** Planning is deciding in advance what is to be done, when it is to be done, how it is to be done. It is basically concerned with the selection of goals to be achieved and determining the effective course of action from among the various alternatives. This involves forecasting, establishing targets, developing the policies and programming and scheduling the action, procedure, etc., Thus, planning requires decisions to be made on what should be done, how it should be done, who will do it, where it will be done, and why it is to be done. The essential part of planning consists of setting goals and programmes of activities.

(b) **Organising :** After the plans have been drawn, management has to organise the activities, and physical resources of the firm to carry out the selected programmes successfully. It also involves determining the authority and responsibility relationships among functions, departments and personnel at various levels to ensure smooth and effective function together in accomplishing the objective. Thus, the organising function of management is primarily concerned with identifying the tasks involved and grouping them into units and departments, and defining the duties and responsibilities of people in different positions within each department for well coordinated and cooperative effort in the organisation.

(c) **Staffing :** Staffing is concerned with employing people for the various activities to be performed. The objective of staffing is to ensure that suitable people have been appointed for different positions. It includes the functions of recruitment, training and development, placement and remuneration, and performance appraisal of the employees.

(d) **Directing :** The directing function of management includes guiding the subordinates, supervising their performance, communicating effectively and motivating them. A manager should be a good leader. He should be able to command and issue instruction without arousing any resentment among the subordinates. He should keep a watch on the performance of his subordinates and help them out whenever they come across any difficulty. The communication system, i.e., exchange of information should take place regularly for building common understanding and clarity. The managers should also understand the needs of subordinates and inspire them to do their best and encourage initiative and creativity.

(e) **Controlling :** This function of management consists of the steps taken to ensure that the performance of work is in accordance with the plans. It involves establishing performance standards and measuring the actual performance with the standards set. If differences are noticed, corrective steps are taken which may include revision of standards, regulate operations, remove deficiencies and improve performance.

Co-ordination : Characterstics and Importance

Management has to ensure that all the activities contribute to the achievement of the objectives of the business as a whole. This requires integration of activities and synchronisation of efforts. The heads of different departments should not treat each other as competitors but should work as organs of one body. As the proper functioning of every organ of a human body is important for a healthy body, the work of every department is important for the organisation as a whole. Managers should, therefore, see that everybody in the organisation understands its objectives and works in co-operation with others to achieve these objectives. This function of management is called co-ordination. It consists of harmonising group effort so as to achieve common objectives.

Characteristics of Co-ordination

1. **Co-ordination is the essence of Management :** Management objectives can be achieved only if there is unity of action among employees. This is possible if the organisation functions with proper harmony. If the activities of an enterprise are not integrated, there is lack of co-ordination. Lack of co-ordination may lead to duplication of work, over lapping of work, conflicts etc.

2. **Co-ordination is Needed at All Levels of Management :** The activities of various departments, units and various individuals in an organisation are inter dependent in nature. So co-ordination is needed at all the levels of management. For example the activities of purchase, production and marketing are inter related.

3. **Co-ordination is a Continuous Activity :** Co-ordination is required in every managerial and operative functions of the business. Activities like purchase, production, finance and marketing are inter related and have to be co-ordinated. So it is a continuous process.

4. **Co-ordination is a Conscious Action :** In order to unite, integrate and harmonize the different activities in an enterprise, co-ordination is an intentional effort of the management.

5. **Co-ordination Attempts to Achieve Objectives :** Individual goals are integrated with organisational goals through levels for common purpose. It adjusts and reconciles individual efforts at all the levels of management. Co-ordination brings efficiency in operations by achieving the objectives of an enterprise.

Notes

Importance of Co-ordination

The meaning and characteristics of cordination indicate that it is of great importance. Without proper co-ordination human efforts may get jeopardized and objectives may not be effectively achieved. The importance of cordination can be explained with the help of the following points:

1. Co-ordinations helps in maintaining harmony among workers in an organisation.
2. Co-ordination prevents over lapping of work and conflict among workers so as to achieve unity of action.
3. In large organisations, various departments and units are located at different places, close interaction among people will be very difficult. So a conscious effort of management is needed to co-ordinate the activities of such organisations. Co-ordinate the activities of such organisations. Co-ordination attempts of achieve cordial human relations.
4. Co-ordination helps to achieve ultimate objective of the organisation by establishing direct contact between management and employees.
5. Co-ordination helps in reducing time and cost of operations.
6. It increases efficiency and moral of the employees.

Co-ordination

Co-ordination is the orderly arrangement of group efforts to provide unity of action for the attainment of a common purpose. Co-ordination synchronises the activities of an organisation. It is the essence of management and is not a separate function of management. It is performed while performing all other functions of management.

INTEXT QUESTIONS 10.3

1. The following table contains the function, position and different levels of management. Pick one from each column and make a meaningful combination.

Levels of Management	*Position*	*Functions*
(A) Top	(a) Departmental heads and managers	(i) Identifying the departmental objectives and guiding lower level towards achievement of objectives.
(B) Middle	(b) Board of Directors and Chief Executives	(ii) Carrying out the operations and their supervisions.
(C) Lower	(c) Supervisors and Foremen	(iii) Defining the objectives and formulating the policies.

2. Given one word substitution of the following.
   (a) Deciding in advance about the future course of action.
   (b) Guiding and supervising the subordinates towards the work.
   (c) It confirms that plans are properly carried out.
   (d) It brings harmony in group.
   (e) It ensures that right type of persons are in the right position.
3. Multiple Choice Questions
   i. Co-ordination is
      a) an objective of an organisation b) goal of an organisation
      c) the essence of management d) none of the above
   ii. __________ force binds all other functions in management.
   iii. The process by which a manger synchronises the activity of different departments is ____________
      a) planning b) organising
      c) staffing d) co-ordination

10.7 PRINCIPLES OF MANAGEMENT

Principles are the basic truths generally stated in the form of cause effect relationship. Management principles are the broad guidelines for the managers for decision making.

Concept

Principles of management are derived on the basis of observation and experimentation studies. Principles of management establishes cause and effect relationship and serve as a guide to thought and action. For example, according to the principle of division of work, specialization is the result of division of work. The cause (dividing the work) and effect (specialisation) can be clearly located.

Management principles are statements of fundamental truth, which provide guidelines for managerial decisions.

Nature of Principles of Management

1. **Universal :** The management principles are applicable to all types of organisations like government enterprises, educational institutions, business enterprises etc.
2. **Flexible :** Management principles are modified and applied according to the changing situations. For example, when an organisation started its functioning, it may have adopted principle of centralisation. When the organisation became a large enterprise, it will apply principle of decentralization.

Notes

3. **Aimed to Influence Human Behaviour :** Human behaviour is complex and unpredictable. Management principles influence human behaviour so that human resources give their best to an organisation. For example, principle of order is followed, so that wasteful movement of workers can be avoided.

4. **Cause and effect relationship :** Management principles indicate clearly the cause of various actions and consequences of various decisions. For example, according to the principle of discipline, smooth running of business is the result of discipline.

Significance of Principles of Management

Management principles have considerable importance in all group efforts. Following are the points of importance of management principles.

1. **Act as a Guide for Research in Management :** The principles so far developed can be tested in new situations and management practices can be made more effective. For example, in earlier days workers were motivated by their remuneration. But now a days family health, education of the children etc. should be considered by the organisation in order to motivate and retain the workers.

2. **Improve Understanding :** The knowledge of principles of management help the managers to manage an enterprise properly. The principles of management help the managers for taking correct decisions. Managers can handle situations smoothly.

3. **Identify the Areas for Training of Managers :** The principles of management help in identifying the areas where the managers should be trained.

4. **Act as Reference for Managers :** Principles act as reference for the managers and help to evaluate whether the decision taken by him are appropriate and accurate.

5. **Increases efficiency :** Principles are guidelines for managers for taking accurate decisions. Principles help the manager for solving problems of an enterprise.

10.7.1 Principles of Scientific Management

Fredric Winslow Taylor identified that the existing management practices were based on trial and error method. F.W. Taylor is known as father of Scientific Management.

Scientific management means the application of scientific methods of study and analysis the problems of management. Taylor developed the following principles for guiding the managers of an organisation. These principles are known as the principles of Scientific Management. The principles of Scientific Management are :

1. **Development of Science for Each Element of Man's Work :** According to this principle, decisions should be based on facts rather than rule of thumb. The work assigned to a worker should be observed. Each element (time taken, fatigue of worker etc.) of work should be analysed. The purpose of such observation is to decide the best way of performing the job. Taylor stressed that each job should be based on scientific study.

2. **Scientific Selection, Training and Development of Workmen :** F.W. Taylor suggested that if an organisation wants to improve the efficiency, it is necessary that workmen are appointed with due care scientifically on the basis of job analysis and job description. So that their skills and experience match with the jobs.

3. **Close Co-operation between Workers and Management :** F.W. Taylor is of the view that there should be close co-operation between workers and management to carry out the work in accordance with the plans and standards.

4. **Mental Revolution :** According to F.W. Taylor, without complete mental revolution of workers and managers, scientific management will not be successful. The workers and managers should have a complete change of outlook with respect to their relations and work efforts. This is called mental revolution.

5. **Maximum Prosperity :** As per this principle, the aim of every management should be to secure maximum prosperity for the employers and employees. This is possible only when each worker is given the opportunity for maximum output rather than restricted output.

6. **Division of Responsibility :** Taylor emphasized that there should be clear cut division of responsibility between management and workers. Planning of work should be the responsibility of managers. Execution work should be done by workers.

10.7.2 Techniques of Scientific Management

Taylor is best known for the techniques of scientific management, particularly in the production department and that too at the shop level. Following are the techniques of Scientific Management as given by Taylor.

1. **Work Studies :** Work study is the systematic, objective and critical examination of all the factors governing the operational efficiency of any specified activity in order to effect improvement. It includes time study, motion study, fatigue study and method study.

   a. **Time Study :** It is a technique of observing and recording the time required to do a price of work and developing the best way of doing it.

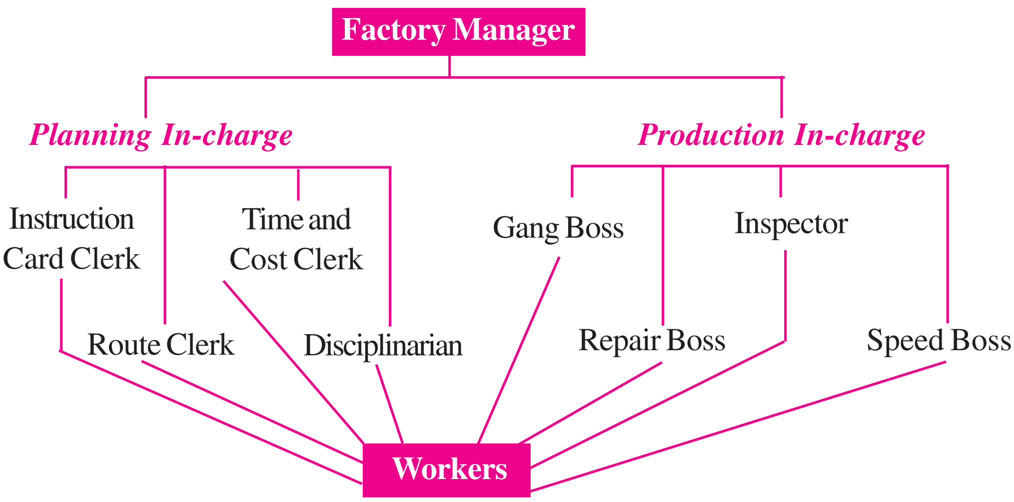
b. **Motion Study :** Under motion study, the movement of men, machines and materials are observed and analysed. Motion study eliminates wasteful motions and help to find the best method of doing a particular job.

c. **Fatigue Study :** Fatigue study means the systematic, objective and critical examination of the causes and consequences of fatigue. This study is aimed to determine the amount and frequency of rest required in completing the work with full capacity.

d. **Method Study :** Method study is concerned with analysing and evaluating the methods (capital intensive or labour intensive) of performing a job. Management should select a best method after considering the following factors : labour cost, availability of capital, material cost etc.

2. **Standardisation :** It refers to the methods of selecting standard materials, machines and tools for use by workers and standardisation of working conditions with respect to lighting, ventilation etc. It will improve the efficient performance of jobs.

3. **Functional Foremanship :** Under functional foremanship, a worker is supervised by several specialist foreman. Eight foremen control various aspects of production.



Foreman under planning Department are :

1. **Route Clerk :** He will determine the process of production and the route through which the raw materials will pass.

2. **Instruction Card Clerk :** He lays down the instructions for workers, who have to follow them to perform their jobs.

3. **Time & Cost Clerk :** He sets the time table for doing various jobs and specify the labour cost and material cost for each operation.

Notes

4. **Shop Disciplinarian :** He has the responsibility to maintain discipline in the factory.

Foremen under Production Department are :

1. **Gang Boss :** He arranges workers, machines, tools and materials etc. for the jobs.
2. **Speed Boss :** He has the responsibility of maintaining the planned speed of production. In case of delay, he investigates the causes and tries to remove them.
3. **Repair Boss :** He has the responsibility of maintaining (cleaning, greasing, oiling etc.) the machines, tolls and equipments.
4. **Inspector :** He has to ensure that output agrees to the standards of quality set by the planning department.

10.7.3 Differential Piece Rate Plan

F.W. Taylor suggested higher payment for those workers who produced standard output or more and lower payment to those who fail to produce standard output. Workers are paid on the basis of number of pieces produced. Due to different rates for different sets of workers, it is known as differential piece rate plan.

Suppose standard output is fixed at 100 units and two workers A and B produced 120 units and 80 units respectively. If the two piece rates are Rs. 1 and Rs. 0.75, A will receive Rs. 120 and B will get only Rs. 60 only. As B receives a lesser pay, he will be under pressure to improve the efficiency and to attain the standard output.

10.8 GENERAL PRINCIPLES OF MANAGEMENT

Scientific management was primarily concerned with increasing the efficiency of individual workers at the shop floor. It did not give adequate attention to role of managers and their functions. However, around the same time Henry Fayol, Director of a coal mining company in France made a systematic analysis of the process of management. He strongly felt that managers should be guided by certain principles, and evolved 14 general principles of management which are still considered important in management. These are:

1. **Division of Work :** This principle suggests that work should be assigned to a person for which he is best suited. Work should be divided into compact jobs to be assigned to individuals. This facilitates specialisation and improves efficiency.
2. **Authority and Responsibility :** Responsibility means the work assigned to any person, and authority means rights that are given to him to manage people and things to ensure performance. In other words, authority should go hand in hand with the responsibility for effective results.

3. **Discipline :** This principle emphasises that subordinates should respect their superiors and obey their orders. On the other hand, superiors' behaviour should be such that they make subordinates obedient. If such discipline is observed, there will be no problem of industrial disputes.

4. **Unity of Command :** A subordinate should work under the supervision of one superior only from whom he gets instructions and to whom he is accountable. It avoids confusion in authority and instructions.

5. **Unity of Direction :** Each group of activities having the same objective must have one head and one plan of action. Otherwise, there may be wastage, over expenditure and useless rivalry among the managers.

6. **Subordination of Individual Interest to General Interest :** While taking any decision, the collective good and collective interest of the organisation as a whole should be preferred to individual interests. The individual's interest should be subordinated to the overall interest of the organisation. This ensures welfare of the organisation as well as its individual members.

7. **Remuneration :** Management should try to give fair wages to the employees so as to ensure reasonable satisfaction of workers and productivity for the organisation.

8. **Centralisation :** When a single person controls the affairs of an organisation, it is said to be complete centralisation. In small concerns, a single manager can supervise the work of the subordinates easily, while in a big organisation, control is divided among a number of persons to facilitate operational decision making at various levels. Fayol's opinion was that there should be a proper balance between centralisation and delegation of authority in an organisation.

9. **Scalar Chain :** This is the chain of authority relationship from the highest to the lowest ranks. This implies that subordinates report to their immediate supervisors who, in turn, report directly to their own boss. The order of this chain should be maintained when some instructions are to be passed on or enquiries are to be made.

10. **Order :** Placement of men and materials should be properly made. Proper space should be made available where materials can be kept safely. Each man should be provided the work for which he is best suited.

11. **Equity :** This principle requires the managers to be kind and just to workers. This promotes a friendly atmosphere between superiors and subordinates and motivates them to perform their duties efficiently.

12. **Stability of Tenure :** Employees should be provided stability and continuity of their tenure of employment. There should not be frequent termination of employees. This could be achieved through attractive remuneration and honourable treatment of personnel.

13. **Initiative :** This implies encouraging initiative among its personnel to chalking out and execution of a plan to achieve the desired results.

14. **Esprit de Corps :** These French words mean team spirit. Managers should infuse the spirit of team work and cooperation among the employees. It helps in developing an atmosphere of mutual trust and a sense of unity.

Fayol made it clear that these principles can be applied to most organisations, but these are not absolute principles. Organisations are at liberty to adopt those which suit them or to delete a few according to their needs.

INTEXT QUESTIONS 10.4

1. What is meant by 'unity of direction'?
2. From the following identify the general principles of management that each sentences implies :
   (a) A person should receive order from one person only.
   (b) Team spirit should be encouraged.
   (c) Managers should be kind and just to workers.
   (d) Instructions should be passed through a well defined path only.
3. Multiple Choice Questions
   i. Who is known as the father of Scientific Management.
      a) Peter F. Drucker　　b) Henry Fayol
      c) Fredrick Winslow Taylor　　d) None of the above
   ii. Name the technique of Scientific Management that lays down that there should be two types of rates of wage payment.
      a) differential piece rate system　　b) standaralisation
      c) functional foremanship　　d) mental revolution
   iii. From the following identify the technique of Scientific Management which lays down that workers should have multiple accountability.
      a) standarlisation　　b) functional foremanship
      c) differential piece rate system　　d) mental revolution

WHAT YOU HAVE LEARNT

- Management is a significant aspect of our day-to-day life. In a business organisation, management helps in better utilisation of inputs like money, raw materials, machines and men and this help in achieving better outputs.
- Management try to achieve several objectives – optimum utilisation of resources, increase in productivity, fair return on capital invested, creation of goodwill and meeting challenges of the changing environment.
- Co-ordination synchronises all the activities of an organisation to achieve the objectives of enterprise. Co-ordination is a continuous activity and it is the essence of management.
- Co-ordination helps in maintaining harmony among workers.
- Importance of Co-ordination include unity of action, prevents overlapping of work, achieve good human relations, increases efficiency and moral of the employees.
- Management is an intangible, continues goal directed, universal activity. It deals with people, hence called a social process. Management is always situational.
- Management helps in achieving goals with efficiency. It ensures both stability and growth keeping in touch with change in the environment.
- Management is an art, science as well as profession.
- Management can be divided into three levels
  - Top level management
  - Middle level management
  - Lower level management
- In every organisation managers perform six important functions
  - Planning
  - Directing
  - Organising
  - Controlling
  - Staffing
  - Coordinating
- Henry Fayol has listed fourteen principles of management, There are
  - Division of work
  - Authority and Responsibility
  - Discipline
  - Unity of command
  - Unity of Direction
  - Subordination of individual interest to general interest
  - Remuneration
  - Centralisation
  - Scalar Chain
  - Order
  - Equity
  - Stability of Tenure
  - Initiative
  - Esprit de Corps
- Principles of management act as a guide for research in management, reference for managers improving understanding and increases efficiency.

- Taylor's Scientific principles are
  - Development of science for each element of man's work.
  - Scientific selection, training and development of workmen.
  - Close co-operation between workers and management.
  - Mental revolution.
  - Division of responsibility.
- Techniques of scientific management include work studies, standaralisation, functional foremanship and differential piece rate plan.

KEY TERMS

Controlling	Initiative	Scalar chain
Co-ordinating	Organising	Unity of command
Directing	Planning	Unity of direction
Equity	Staffing	
Esprit de corps	Scientific management	

TERMINAL EXERCISE

Very Short Answer Type Questions

1. Define the term 'Management'.
2. What do you mean by Co-ordination?
3. List different levels of management.
4. State the meaning of Esprit de Corps.
5. What is meant by subordination of individual interest to general interest?
6. Define the term 'Equity' as a principle of management.
7. State any one principle of Scientific Management.
8. What is meant by motion study?

Short Answer Type Questions

9. State any three objectives of management.
10. Mention the different characteristics of management.
11. Explain the meaning of 'management as a discipline'.
12. Can management be treated as a profession? Give reasons in support of your answer.
13. What is meant by scientific management?

14. State any three characteristics of principles of management.
15. Explain the importance of principles of management.
16. What is meant by principles of management?
17. What do you mean by Mental revolution?

Long Answer Type Questions

18. Explain Co-ordination as the essence of management.
19. Describe the characteristics of management.
20. Explain the importance of coordination.
21. Explain the objectives of management.
22. Describe the importance of management.
23. State the various functions of management.
24. State the fourteen principles of management given by Henry Fayol.
25. Explain any three characteristics of management.
26. Explain management as a discipline and as a group.

ANSWERS TO INTEXT QUESTIONS

10.1 2. (b) INTANGIBLE (d) SITUATIONAL
(c) SOCIAL (e) CONTINUOUS

3. (a) Optimum utilisation of resources
(b) Increase in productivity
(c) Fair return on
(d) Credit Goodwill
(e) Meet Challanges of changing environment (any three)

10.2 1. Art: (b), (d) Science: (a), (c) Profession: (e)

2. (a) - (iii) (b) - (iv) (c) - (i) (d) - (ii)

10.3 1. (A) - (b) - (iii) (B) - (a) - (i) (C) - (c) - (ii)

2. (a) Planning (b) Directing (c) Controlling
(d) Coordination (e) Staffing

3. (i) c (ii) Co-ordination (iii) d

10.4 2. (a) Unity of command (b) Esprit - de-corps (c) Discipline
(d) Equity (e) Scalar Chain

3. (i) c (ii) a (iii) b

Notes

DO AND LEARN

1. Visit a nearby organisation. Make a list of all the people working there and categorise on the basis of which level of management they belong to.
2. Suppose your mother is the head of your family. List all the activities she does in her daily life. Put these task into different functions of management.

ROLE PLAY

Anubhav has just finished his Sr. Secondary Course from NIOS. His father, a businessman is happy that now his son will help him in his business. But, to his displeasure Anubhav does not want to join the business now. He first wants to do BBA (Bachelor of Business Administration) and then join his father in business.

Father : Anubhav, what is the need for BBA degree? Eventually you are going to join my business. Then why waste three precious years in studying for a management degree. I didn't do any management course still I am doing fine.

Anubhav : Papa, You started this business thirty years ago. Business environment was comparatively stable. By trial and error and after many ups and downs you have reached here. But in today's world of globalisation, changing technology and communication etc., one must learn to apply management principles. Very soon we may survive but not able to compete.

Father : Means?

Anubhav : In today's changing world with declining resources, management helps us in achieving our targets more effectively and efficiently.

Father : I have been managing.

Anubhav : But we may not be able to compete effectively. Anubhav explained in details the significance of management to his father.

(Choose a role for yourself and the other for your friend and continue the conversation.)

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11

PLANNING AND ORGANISING

In the previous lesson, you learnt about the various functions of management, viz., planning, organising, staffing, directing, coordinating and controlling. In this lesson we shall discuss the first two functions i.e., planning and organising emphasising the nature, importance, process of planning with its limitations and types, and the basic concepts of organising including process of organising, the organisation structure, delegation and decentralisation of authority.

OBJECTIVES

After studying this lesson, you will be able to:

- explain the meaning and features of planning;
- describe the importance of planning;
- identify the steps involved in process of planning;
- explain the meaning and importance of organising;
- outline the steps involved in process of organising;
- limitations of planning;
- explain the concept of organisation structure and outline the forms it takes;
- differentiate between formal and informal organisation and
- explain the concepts of delegation and decentralisation of authority and the distinction between the two.

11.1 WHAT IS PLANNING

When we talk about planning, it simply refers to deciding in advance what is to be done and how it is to be done? For example, you decide in advance where to study (at

NIOS or regular school) and what to study (to go in for Business Studies and Accountancy or Physics and Chemistry) etc. and plan for the admission, transport arrangement and purchase of books and stationeries etc. Thus, planning is a systematic way of deciding about and doing things in a purposeful manner. In the context of business organisations and their management it may be defined as the process of setting future objectives and deciding on the ways and means of achieving them. In the words of M.E. Hurley "planning is deciding in advance what is to be done in future. It involves the selection of objectives, policies, procedures and programmes from among the alternatives".

11.2 FEATURES OF PLANNING

The basic features of planning can be summarised as follows:

(a) Planning is the primary function of management as every activity needs to be planned before it is actually performed. In other words, planning precedes all other managerial functions and provides the very basis for organising, staffing, directing and controlling.

(b) Planning is always goal directed. A manager cannot plan anything unless he knows what he wants to achieve. For example, you cannot plan for a journey unless you know where you want to go. Thus, planning is taking such steps so as to achieve the desired goal.

(c) Planning is pervasive at all levels of management and so also for all functional area. Managers at the top level plan for the entire organisation. They make plans for a long period and lay down the objectives for the organisation as a whole. Middle-level managers make quarterly, half-yearly and yearly plans for the departments under them. Foremen and office supervisors plan for a workshop or a section of the office. They make plans for a short period, i.e., for the next day, next week or next month.

(d) Planning is always futuristic. It is deciding in advance what to do, how to do, etc. It requires collection of information about various matters relating to business and then choosing a course of action for the future. However, while planning for the future, it does take past experience and current situation into consideration.

(e) Planning is an intellectual activity and requires certain conceptual skills to look ahead into the future. It needs good foresight and sound judgment to anticipate future events, develop alternative courses of action and make the right choice.

(f) Planning is a continuous process. In organisations plans are made for a specific period followed by new plans for further period. Sometimes the conditions or circumstance change requiring the plans to be revised. For example, a sugar factory situated in upper regions of Uttar Pradesh had planned for 1,000 tonnes of sugar during the last quarter of the year. Accordingly, the management planned for procurement of sugar cane from the nearby areas. Unfortunately, there was snowfall leading to loss of crop. This made the management to change their plan and procure sugarcane from far off areas like Haryana and Rajasthan and also revise their planned production of 1000 to 800 tonnes. Thus, planning is a continuous activity in organisations.

(g) Planning basically involves making choices. Need for planning arises when goals/ objectives are many and alternatives to achieve them are also plenty. While planning, alternatives are evaluated and a choice is made regarding which course of action is to be followed.

(h) Planning is flexible. Planning is done on the basis of some forecasts which may not materalise. Hence, plans have to be changed in accordance with the changed conditions. Activities are planned with certain assumptions, which may not come true. Managers must make provision for alternate strategies and plans as indicated in the earlier example of a sugar factory.

11.3 IMPORTANCE OF PLANNING

Planning is the most important of all the management functions. Some of the points of importance are as follows:

(a) Planning reduces uncertainty, risk and confusion in operation. Through planning, the future course of action is known to all and so, everybody knows exactly what needs to be done. This gives a sense of direction resulting in efficiency in operations.

(b) Planning guides the decision making by the managers. Planning of goals to be achieved and the course of action to be followed to achieve the goal act as a guide in their own decision making and action plans.

(c) Planning helps in achieving coordination and facilitates control. Proper planning integrates the tasks at the operational level, thereby making coordination more effective. It also helps in identifying deviations and taking the corrective action.

(d) Planning with an element of flexibility makes the organisation adaptable. In other words planning makes the organisation capable of coping with the changing environment and facing challenges.

(e) Planning leads to economy and efficiency in operations. Best methods are selected out of available choices, thus, reducing overlapping and wasteful activities.

(f) Planning begins with the determination of objectives and directed towards their achievement. It keeps the executive alive and alert. Managers have to review the progress periodically and recast their strategies to meet the objectives.

It should be noted that planning also has certain limitations, as the plans are based on certain assumptions and incomplete information. Hence, the management has to be vigilant and provide for necessary flexibility to take care of changed situations.

11.4 LIMITATIONS OF PLANNING

Planning is of great importance to management. Inspite of this fact, it suffers from some limitations. Following are the important limitations of planning :

1. **Rigidity :** The existence of a plan puts managerial activities in a rigid framework. Changes are not acceptable to the employees. This attitude makes employees and managers inflexible in their operations.

2. **Probabilistic :** Plans are based on forecast so they do not reflect reality. Predictions may not be correct and plans based on these predictions may go wrong. For example, even developed countries like America, UK, France etc. did not forecast sub-prime crisis, which resulted in a major economic crisis in those countries.

3. **Expensive and Time Consuming :** Planning requires a lot of time to collect information, its analysis and interpretation. So it is a time consuming process. It is not practicable during emergency. If the benefits derived are not more than the cost of plan, then it has adverse effect on the financial performance of an organisation.

4. **Delay in Actions :** Planning is a time consuming process. In case of urgent decisions, planning will delay the action.

5. **Misdirection :** Sometime planning may be used to serve individual and group interests and interest of the organisation may be ignored.

6. **False Sense of Security :** Planning may create a false sense of security among the employees of an organisation in the sense that since the activities will take place as per plan therefore, there is no need to worry.

INTEXT QUESTIONS 11.1

1. Define the term Planning.

2. Read the statements given below. Write against each if it represents a feature, or importance of planning or neither.

   (a) Planning is the primary function of management.

   (b) Planning brings about efficiency and effectiveness.

   (c) Planning is always futuristic.

(d) Planning reduces uncertainty, risk and confusion.

(e) Planning helps in achieving coordination and control.

3. From the following identify the limitations of planning

(a) Rigidity

(b) Facilitates Control

(c) Time Consuming

(d) Reduces Uncertainity

(e) Delay in Action

(f) Leads to economy

11.5 THE PLANNING PROCESS/STEPS IN PLANNING

Planning in organisation follows a step-by-step process without which it may be difficult to build up proper plans and ensure their implementation. Such steps are as follows.

1. **Establishment of Objectives :** All of us know that every organisation has some goals that it wants to achieve. Planning actually starts with defining these goals in more concrete, clear and unambiguous terms. This enables the management in gaining clarity on what they have to achieve and then plan all activities accordingly. Hence establishing organisational objectives is a pre-requisite for good and meaningful planning.

2. **Making Assumptions (establishing premises) about the External and Internal Conditions :** Making assumptions about the future environment of business is the second step in planning. For example, it may be assumed that there will not be any change in tax laws and that there will be sufficient funds available to meet its financial requirements. These assumptions about the future environment of the business are known as **planning premises**. These premises may be **external** or **internal**. External planning premises relate to conditions outside the business. Internal planning premises relate to conditions prevailing within the organisation.

   External planning premises include assumptions about the market demand and nature of competition, laws affecting the business, availability of resources, and changes in technology. If the management can visualise the likely changes in the external conditions, they can take steps to solve problems arising there from and plan to take advantage of the emerging business opportunities. Government policies and laws, for example, affect the decisions of managers to a great extent. Advance knowledge of the likely changes in government policy enables managers to plan their activities more appropriately.

Internal planning premises relate to conditions within an organisation. These conditions include cost, methods and techniques of production, employees, type of machinery and equipment, etc. All these constitute the internal resources which determine as to what the organisation is capable of achieving.

The study of external conditions enables a business unit to know the opportunities available in the market. Hundreds of opportunities are available to a business unit, but it cannot take advantage of every opportunity. It has to decide what it will produce and distribute in the light of what it can do i.e., on the basis of the study of internal factors and then plan accordingly.

3. **Development of Alternative Courses of Action :** The next step in planning is to identify the alternative courses of action to achieve the objectives set. For example, to achieve the objective of increasing the profits of a business unit, any one or more of the following alternatives can be used:

   - Increase the sale of its existing products
   - Improve product quality
   - Add new products/product lines
   - Increase the prices of products
   - Reduce costs

4. **Evaluation of Alternatives :** Evaluation of alternatives is the fourth step in planning. When alternative courses of action are there before a manager, he has to examine the feasibility and the possible results of each course of action before selecting the best course. Certain alternatives may not be practicable. Management should ignore such alternatives. For example, to maximise profits the management may not think of reducing the wages of workers as it may not be workable. Similarly, if prices are increased, the business unit may not be able to face competition in the market. So, the management should evaluate each of the remaining alternatives and work out how far they help in meeting the objectives and whether these are workable in the light of available resources.

5. **Selecting the Appropriate Course of Action :** After evaluating the alternatives the manager will select that alternative which gives maximum benefit at minimum cost. In selecting the best course from among the alternatives, managers should also keep in mind their own limitations of resources. So in making the final selection from among the alternative courses of action, the management will ultimately be guided by:

   (a) the opportunities provided by the external environment; and

   (b) the ability of the business unit to take advantage of these opportunities.

6. **Arranging for Implementation :** After the management has finalised their choice, it should build up the necessary strategies and action plan for its implementation in due consultation with all key personnel who are to implement it.

INTEXT QUESTIONS 11.2

1. Rearrange the following elements of external and internal planning premises.

External Planning Premises	*Internal Planning Premises*
(a) Methods of production	(i) Market demand
(b) Availability of skilled labour	(ii) Change in technology
(c) Change in govt. policy	(iii) Use of modern machinery

2. Ramesh wants to appoint mangers in different departments of his factory. He follows the following steps, which are not given in proper order. Arrange them carefully in correct sequence in the table given below.

   (a) Appointed three managers.

   (b) Visited two management institutes to interview the management graduates.

   (c) Compared the short listed candidates in terms of qualification and salary expected.

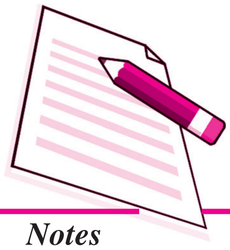
   (d) Set assumption that the technology is going to change; and that enough money is available for payment of salaries to the new managers.

   (e) Set a target of appointment of three managers.

11.6 TYPES OF PLANS

1. **Objectives :** Objectives are the end results towards which all the activities are directed. eg. it can be the objective of an organisation to impart training in cloth printing to 1000 persons in a year. As far as possible objectives should be measurable in quantative terms and should be achievable.

2. **Strategy :** To exist in the changing business environment and to face the competitions in the market plans that are formulated are called strategies. Strategies refer to plans which are prepared by considering the more of competitors for the optimum utilisation of resources. Strategy is a comprehensive plan which indicates the desired future of an organisation. e.g. (i) Tata adopted the strategy of attracting even middle income group to purchase cheaper car (Nano). (ii) Because of labour turnover, IT companies adopted the strategy of appointing not only engineers but also graduates from Maths and Physics discipline.



Notes

3. **Policy :** A policy is a general statement that guides decision making. It decides the boundaries within which the decisions can be made. Policies direct decisions towards achievement of objectives. For e.g. an organisation may have policy of giving training only to candidates who secured more than 60 percent marks.

4. **Procedure :** Procedures are plans which determine the sequence of any work performance. If procedures are decided in advance, everyone can follow the same. For e.g. the procedure for giving training to candidates in an organisation.

   a. Collect the application from candidates.

   b. Verify the scores / mark of each candidate.

   c. Verify the area of training needed by each individual (cutting & measuring a piece of cloth for stitching).

   d. Collect fees / decide the stipend to be given to each candidate.

   e. Send letters intimating the date and period of training.

   f. Conduct training programme on completion of training.

   g. Issue of certificate to each participant.

5. **Methods :** Method is that plan which determines how different activities of the procedure are completed. A method is not related to all steps but only to one step of the procedure. One best method is selected in which a worker feels minimum fatigue and there is increase in productivity. Methods are standardised way of doing work. For e.g. cloth can be manufactured by labour intensive method or capital intensive method. But most efficient is one which will use least amount of scarce resources.

   The method of car driving training can be by using a car or by using a computer software in the initial period of training.

6. **Rule :** Rules clearly indicate what is to be done and what is not to be done in a particular situation. Strict actions can be taken against persons who violate the rules. Rules are guideline designed to guide behaviour. For e.g., there can be rule of 'Keep Silence' in a library or 'No smoking' in a factory.

7. **Budget :** It is a statement of expected results expressed in numerical terms. A budget is a type of plan expressed in financial terms or in terms of labour hours, units of product, machine hours etc. Budgets are quantitative statements indicating expected results and expenditure required for achieving the goal. For e.g., Cash budget estimates the expected cash inflow and cash outflow over a period of time.

8. **Programme :** A programme is a plan laying down the what, how, who and when of accomplishing a specific job. The programmes are mode to get a systematic working in the organisation. Programme is a scheme designed to accomplish a specific objective. It spells out clearly the steps to be taken, resources to be used, and time period within which the task is to be completed. A programme usually includes a set of objectives, policies, procedures, methods, budgets etc. e.g. developing a new product, training programme, advertising programme etc.

INTEXT QUESTIONS 11.3

1. Identify the plan which is numerical and can be expressed is monetary terms.

   a) objective   b) strategy

   c) budget   d) policy

2. A company formulated a plan to conduct training for 6 months. What type of plan is it?

   a) objective   b) programme

   c) budget   d) none of the above

3. A company frames a plan which mentions that workers should punch their entry card before 10:15 a.m. What type of plan is it?

   a) objective   b) rules

   c) budget   d) none of the above

11.7 ORGANISING

Organising is the next important function of management after the planning. You know that in case of planning a manager decides what is to be done in future. In case of organising, he decides on ways and means through which it will be easier to achieve what has been planned. Suppose, it is planned to start a new plant for soft drinks within six months. The immediate task for the manager then is to identify and assign the various tasks involved, and devise structure of duties and responsibilities so that things move smoothly and the objective is achieved. All these tasks form part of organising function. Thus, organising refers to the process of :

- Identifying and grouping the work to be performed.
- Defining and determining responsibility and authority for each job position.
- Establishing relationship among various job positions.
- Determining detailed rules and regulations of working for individuals and groups in organisation.

Notes

11.8 IMPORTANCE OF ORGANISING

Organising is essential because it facilitates administration as well as operation of enterprise. By grouping work and people properly, production increases, overload of work is checked, wastage is reduced, duplication of work is restricted and effective delegation becomes possible. Secondly, organising facilitates growth and diversification of activities through clear division of work. It helps in developing a proper organisation structure and the extent and nature of decentralisation can be determined. In addition to the above, organising also provides for the optimum use of technical and human resources. It also encourages creativity and enhances interaction among different levels of management which leads to unification of efforts of all.

11.9 PROCESS OF ORGANISING

The process of organising consists of the following steps –

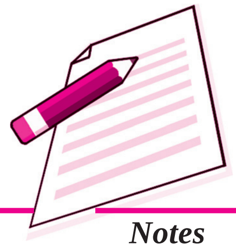
1. **Identification of activities :** Every enterprise is created with a specific purpose. Based on this, the activities involved can be identified. For example, in a manufacturing firm, producing goods and selling them are the major activities in addition to routine activities like, paying salary to employees, raising loans from outside, paying taxes to the government etc. and these activities vary when the organisation is a service concern or a trading firm. Therefore, it is essential to identify various activities of an enterprise.

2. **Grouping of activities :** Once activities are identified, then they need to be grouped. They are grouped in different ways. The activities which are similar in nature can be grouped as one and a separate department can be created. For example – activities undertaken before sale of a product, during the sale of the product and after the sale of the product can be grouped under the functions of a marketing department. Normally, all activities of a manufacturing unit can be grouped into major functions like purchasing, production, marketing, accounting and finance, etc. and each function can be subdivided into various specific jobs.

3. **Assignment of Responsibilities :** Having completed the exercise of identifying, grouping and classifying all activities into specific jobs, they can be assigned to individuals to take care of.

4. **Granting authority :** On the basis of responsibilities given to specific individuals, they are also to be given the necessary authority to ensure effective performance.

5. **Establishing relationship :** This is a very important job of management as everybody in the organisation should know as to whom he/she is to report, thereby establishing a structure of relationships. By doing so, relationships become clear and delegation is facilitated.



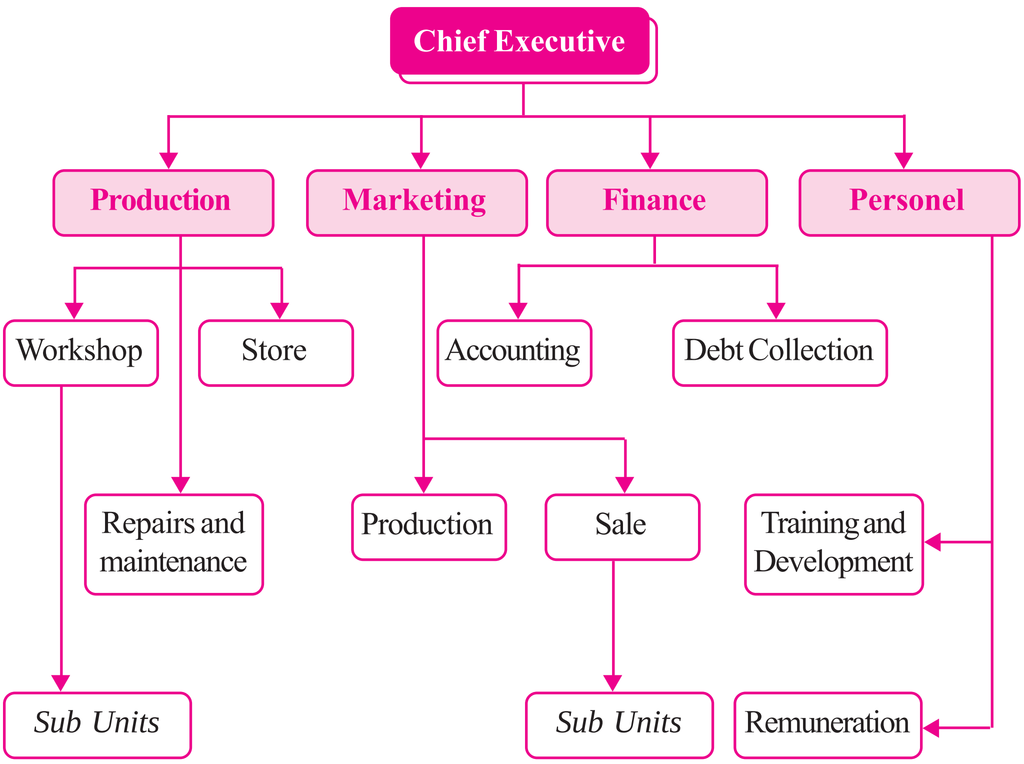
Notes

11.10 ORGANISATION STRUCTURE

The process of organisation culminates into an organisation structure which constitutes a network of job positions and the authority relationships among the various positions. The various factors that are usually taken into consideration for designing a good organisation structure are job specifications, departmentation, authority-responsibility relationships, etc. The whole structure takes the shape of a pyramid (look at the type of structure that follow) and broadly indicates the tasks assigned, the hierarchical relationships and the patterns of communication and coordination. Based on the arrangement of activities, two most commonly used forms of organisation structure are (1) functional structure, and (2) divisional structure. These are discussed as under.

1. **Functional Structure :** An organisation structure formed by grouping together all activities into functional departments and putting each department under one coordinating head is called functional structure. Thus, in any industrial enterprise the functions like manufacturing, marketing, finance, personnel may constitute the major separate units (departments) of the enterprise; and in case of a large retail store purchasing, sales and warehousing may be the major units. It may be noted that the major units use are further divided into sub-units. For example, the manufacturing department may be sub-divided into stores, repairs, maintenance, production, etc.

Functional Structure



Notes

This form of organisation structure helps in developing functional specialisation in each unit duly headed by an expert in that functional area. This facilitates the coordination within the department since all are fully familiar with the various activities involved. However, this type of structure is considered suitable for small and medium size organisations. In case of large organisations, the units become too unwieldy and difficult to manage.

2. **Divisional Structure :** In large organisations dealing in multiple products and serving a number of distinctive markets, the divisional structure is considered more suitable. Under such structure the organisation is divided into units entrusted with all activities related to different products on different territories (markets). Each divisional head is required to look after all functions related to the product or market territory.

Divisional Structure
(Product based)

Chief Executive

- Personnel
- Automobile
  - Personnel
  - Production
  - Marketing
  - Accounting
- Finance
- Refrigerators
  - Personnel
  - Production
  - Marketing
  - Accounting
- Marketing

Under divisional structure, most activities associated with a product or product group can be well coordinated and its profitability easily ascertained. Moreover, it provides opportunity to divisional managers to take prompt decisions and resolve all sorts of problems without much difficulty. However, this structure is expensive and gives rise to duplication of efforts.

INTEXT QUESTIONS 11.4

1. What is meant by the functional structure of organisation?
2. Arrange the following steps of organising in proper sequence in the table given below.
   (a) Assigning responsibility.
   (b) Identification of activities to be done.
   (c) Granting authority.
   (d) Establishing relationships among individuals and groups.
   (e) Grouping and sub-dividing activities within each function on the basis of similarity or relatedness.

11.11 FORMAL AND INFORMAL ORGANISATION

Formal organisation refers to the officially established pattern of relationships among departments, divisions and individuals to achieve well-defined goals and is a consciously designed structure of roles. In other words, formal organisation clearly spells what a person has to do, from who he has to take orders and what rules, policies and work procedures are to be followed. Thus, it is a system of well defined jobs, each bearing a definitive measure of authority, responsibility and accountability. This promotes order and facilitates planning and controlling functions.

Informal organisations on the other hand, refers to relationship between individuals in the organisation based on personal attitudes, likes and dislikes and originates to meet their social and emotional needs and develops spontaneously. It represents natural grouping of people in work situation and is supplementary to formal organisation as it serves the needs not satisfied by formal organisation. The formal organisation does not provide opportunity to members to exchange personal views and experiences and so they interact informally to fulfill such interest and needs. In fact, informal organisation comes into being because of the limitations of the formal structure and both are interlinked. However, they differ in respect of their origin, purpose, structure, authority, channels of communication and behaviour of members.

11.11.1 Difference between Formal and Informal Organisations

Formal Organisation	*Informal Organisation*
1. It is created by the top management.	It is not created by top management. It arises out of the natural desire of the people to associate.
2. It is created to get the jobs of an organisation performed in a planned and systematic manner.	It is formed to satisfy those needs of members which can not be satisfied through formal organisation.
3. It is managed by officially appointed managers.	Members of the informal group select some one as their leader to take care of the interests of the group members.
4. Managers of formal organisation have formal authority.	The authority of the leader of the informal group depends upon the combined support of group members.
5. Formal organisation is permanent and stable.	Informal organisation is of temporary nature. It changes its size and membership from time to time.

11.12 DELEGATION

In organisations, it is difficult on the part of a manager to complete all the jobs assigned to him. He thus, can take help from others by asking them to do some of the work in a formal way. It means, he can assign some of the work to his subordinate and give them authority to carry on the work and at the same time make them accountable. For example, a production manager may have the target to produce 1000 units in a weeks time. He can distribute his work to three of his subordinates to produce 250 units each and keep 250 units for self to produce. And then he must also give them enough authority to use organisational resources to produce. By doing so he also makes his subordinates answerable to him for non-performance.

This active process of entrustment of a part of work or responsibility and authority to another and the creation of accountability for performance is known as delegation. Thus, there are three elements of delegation as follows.

1. **Assignment of Responsibility :** This is also known as entrustment of duties. Duties can be divided into two parts: one part, that the individual can perform himself and the other part, that he can assign to his subordinates to perform.

2. **Granting Authority :** Authority refers to the official powers and position required to carry on any task. When duties are assigned to subordinates then the required authority must also be conferred to him. For example, when a manager asks his subordinate to receive a guest of the company on his behalf then he must also grant him some authority like carry the company vehicle, booking the company guest house for accommodation etc.

3. **Creating Accountability :** This refers to the obligation on the part of the subordinates, to whom responsibility and authority are granted to see to it that the work is done. In other words, the delegatee is fully answerable to his superior for performance of the task assigned to him. Thus, the superior ensures performance through accountability by his subordinate.

11.12.1 Importance of Delegation

Delegation is considered as one of the most important elements in the process of organisation because, it reduces the load on managers as work is successfully shared by the subordinates. This improves the managerial effectiveness because by delegating a good part of work to the subordinate the managers are able to concentrate on important matters which requires personal attention. Not only that, the organisations now-a-days are usually large in size and complex in character, and no manager can claim to have all the skills and expertise to handle all kinds of jobs himself. Moreover, the business activities are spread over a larger area with several branches and units, which makes it difficult for him to supervise all the activities personally at all places. The delegation of responsibility with commensurate authority offers a good workable solution. This also provides an opportunity for subordinates to develop, and motivates and prepares them for taking up higher responsibilities in future. It leads to creating a healthy work environment and harmony among the employees. Thus, delegation facilitates organisational growth and prosperity.

11.13 DECENTRALISATION

Decentralisation refers to a systematic effort to delegate authority at all levels of management and in all departments. This shifts the power of decision making to lower level under a well considered plan. Take the case of traffic police controlling movement of vehicles on road. He holds a lower level position in the organisation yet he has lot of authority given to him. The senior concentrate on ways and means to improve traffic control. In case of business units, the heads of departments have the authority to take decisions on most matters relating to the functioning of their department. The top managers are confined themselves to policy decisions like product lines to be added, further investment etc.

Decentralisation has number of benefits. Firstly, it reduces the workload of the top level management. Secondly, it motivates the employees and gives them more autonomy. It promotes initiative and creativity. It also helps employees to take quick and appropriate decisions. In this process, the top management is freed from the routine jobs and it enables them to concentrate on crucial areas and plan for growth.

11.13.1 Distinction Between Delegations and Decentralisation

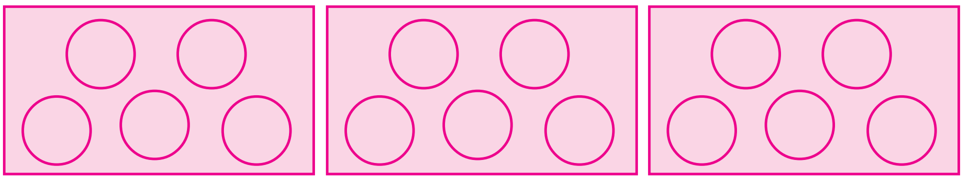
Decentralisation is not same as delegation. The points of differences are -

- While delegation is the process of assigning responsibility and authority and thereby creating accountability; decentralisation is the ultimate outcome of planned delegation.
- Delegation of authority takes place between the manager and his subordinates while decentralisation involves the entire organisation, and is between top management and divisions/departments.
- Delegation is done to speed up the work and is essential in trace; while decentralisation is optional and is usually done in large scale organisations.
- In case of delegation the responsibility and authority delegated may be withdrawn by the delegator; which is not so easy in case of decentralisation.

INTEXT QUESTIONS 11.5

1. Identify the following as formal or informal organisation.
   - (a) Students enjoying a picnic in a park.
   - (b) Workers of the Health department are engaged in cleaning the roads.
   - (c) People gathered for marriage party.
   - (d) Workers of Production department working at the machines.
   - (e) Tutors of NIOS PCP classes tutoring.
2. Following is a list of decisions to be taken by a manager of an organisation. Write against each what kind of authority is needed for the decision-making.
   - (a) Production manager giving instructions to Foreman for target output.
   - (b) Head of Engineering department giving instructions regarding security norms to be kept in mind.
   - (c) Head of the marketing research unit asking for some value addition to the product.
   - (d) Personnel manager recommending names for recruitment in the sales department.
   - (e) The Chief Executive Officer asking General Manager to ensure 25% reservation in recruitment.

Line Staff Functional



WHAT YOU HAVE LEARNT

- Planning is deciding in advance what is to be done and how it is to be done.
- Planning is a primary function of management. It is all pervasive, intellectual, futuristic and continuous activity. It is a flexible activity dealing with making choice when many alternatives are available.

- Planning is very important function of management. It helps in achieving economy, efficiency, coordination and facilitates proper control.
- Planning process:
  - establishment of objectives
  - making assumptions about external and internal conditions
  - development of alternative course of action
  - evaluation of alternatives
  - selecting the appropriate course of action
  - arranging for implementation.
- Planning suffers from several limitations : rigidity, probabilistic, expensive and time consuming, delay in actions, misdirection, false sense of security.
- Objectives are the aims which an organisation seeks to achieve.
- Strategy indicates the desired future of an organisation.
- Policy define the boundaries within which decisions can be made and they direct decisions towards the accomplishment of objectives.
- Procedures are chronological sequence of steps to be taken to implement policies.
- Methods are standardised way of doing work.
- Rules are guidelines designed to guide behaviour.
- Budgets are quantitative statements indicating expected results and expenditure required for achieving the goal.
- Programme is a scheme designed to accomplish a specific objective.
- Organising is the next important function of management after planning. It refers to identifying and grouping the activities to be performed, defining the responsibility and authority for each job position, establishing relationships between various job positions and determining detailed rules and regulations of working.
- An organisation structure formed by grouping together all activities in to functional departments and putting each department under one coordinating head is called functional structure.
- When the organisation is divided into units entrusted with all activities related to different products or on different territories, it is called divisional structure.
- Delegation is the process of entrustment of part of work or responsibility and requisite authority to another person and creating accountability for performance.

Notes

- Decentralisation is the effort to delegate authority at all levels of management.
- Formal organisation refers to the officially established pattern of relationship among departments, divisions and individuals to achieve well-defined goals. Informal organisations on the other hand, refers to relationship between individuals in the organisation based on personal attitudes, likes and dislikes and originates to meet their social and emotional needs and develops spontaneously.
- Authority means the right to take decision, right to issue orders and right to take action if orders are not carried out. On the basis of the nature, it can be of three types viz., Line authority, Staff authority and Functional authority.

KEY TERMS

Accountability	Functional authority	Planning
Authority	Functional structure	Planning premises
Decentralisation	Informal organisation	Responsibility
Delegation	Line authority	Staff authority
Formal organisation	Organising	

TERMINAL EXERCISE

Very Short Answer Type Questions

1. List any two limitations of planning.
2. Name any two types of plan.
3. Define the term Organising.
4. What is meant by planning premises?
5. Explain the meaning of authority.
6. Define the term delegation.
7. Give the meaning of decentralisation.

Short Answer Type Questions

8. Stare the different steps of planning process.
9. Differentiate between external and internal planning premises.
10. What is functional authority? How is it different from line authority?

11 State the different elements of delegation.

12. Mention the different steps of organising.

13. Why rule should be considered as a plan?

14. Write short notes of 'Procedure'.

Long Answer Type Questions

15. Explain the features of planning.

16. What is meant by planning? Describe any four points of importance of planning.

17. What is organising? Describe the steps in the organising process.

18. Explain the meaning of formal and informal organisations. What are the differences between these two?

19. If a person is responsible for supervising employees, why must that person have authority?

20. Write short notes on Rules, Procedures, Budget and Programme.

21. Explain 'Rules' and 'Methods' as types of plan. Differentiate between the two.

22. Explain the limitations of planning.

ANSWERS TO INTEXT QUESTIONS

11.1	2.	Features – (a) , (c)		Importance - (b), (d), (e)		
	3.	(a), (c), (e)				
11.2	1.	External Planning Premises - (b); (c); (i); (ii)				
		Internal Planning Premises - (a); (iii)				
	2.	1 (e)	2 (d)	3 (b)	4 (c)	5 (a)
11.3	1. (c)	2. (b)	3. (b)			
11.4	2.	1 (b) 2 (e)	3 (a)	4 (c)	5 (d)	
11.5	1.	Formal - (b), (d), (e)		Informal - (a); (c)		
	2.	Line- (a); (e)	Staff - (b); (c)	Functional - (d)		

Notes

DO AND LEARN

Visit the nearest grocery shop and ask the shopkeeper to list the activities he did to set up his shop. Now differentiate the activities into planning and organising.

ROLE PLAY

Aditya and Abhinandan studied together. After finishing their studies they started their own business at different places. They do not find time to meet each other. Whenever Aditya fixes up a meeting Abhinandan excuses himself saying there is a problem in the organisation. Aditya visited him one-day in his office.

Aditya	:	Abhinandan! Why there is always a problem in your organisation?
Abhinandan	:	Well, I can't make out! I have good number of people working for me in different areas. But, there is a confusion and argument about who has authority, responsibility and accountability in respect of different activities.
Aditya	:	Have you ever sit down and listed all the activities of your organisation? Grouped them? Assigned specifically to each of them?
Abhinandan	:	No! But how will it help?
Aditya	:	Friend, what you need is not only number of people but also ensure that activities are properly identified, grouped and assigned to competent people.
Abhinandan	:	Means?
Aditya	:	Means, proper organisation.

(Thereafter Aditya explained to Abhinandan about the importance of proper organisation)

Place yourself as Aditya and one of your friends as Abhinandan and continue the conversation.

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12

STAFFING

In a small business unit, like a grocery shop, the owner may not need others to help him in running the shop, as he may himself be able to look after all the activities. But as the business grows in size he may find it difficult to manage all the activities alone and may have to find out suitable persons and employ them. It is quite possible that you may start your own business and face such a situation and employ people to assist you in running the business. Alternatively, you yourself may be a job seeker. In both the situations, you may find it useful if you know how employees are recruited, selected and trained for the various positions in an organisation. In this lesson, you will learn in detail about the staffing function including the sources of recruitment, the process of selecting the employees with the importance of training and development and the various methods of their training.

OBJECTIVES

After studying this lesson, you will be able to:

- explain the meaning and importance of staffing;
- identify the steps involved in the process of staffing;
- describe staffing as a part of Human Resource Management;
- state the meaning of recruitment;
- explain the process of selecting employees;
- explain the meaning & importance of training and development;
- describe various methods of training and
- outline the methods of performance appraisal, compensation, promotion and transfer.

12.1 MEANING OF STAFFING

Staffing refers to the managerial function of employing and developing human resources for carrying out the various managerial and non-managerial activities in an organisation. This involves determining the manpower requirement, and the methods of recruiting, selecting, training and developing the people for various positions created in the organisation. This, in fact happens to be a continuous process because the organisation's need to retain and update its personnel is a never ending exercise. The managers have to keep a regular watch on the number and composition of the personnel needed by the organisation, because the requirement of manpower keeps on changing and expanding with the expansion of activities and additions of new departments and work units. Not only that, at any point of time, some people will be leaving, retiring, getting promotion or transferred. The vacancies thus created have to be filled up.

It may be noted that staffing function is an integral part of human resource management and, in its wider sense, also includes the activities of determining the remuneration of workers, appraising their performance, and deciding on their promotion, transfers, etc.

12.2 IMPORTANCE OF STAFFING

All of us know that it is the people in every organisation who run the show successfully. For example, if you do not have good salesman you cannot sell well even if your product is good. Similarly, you may have the best quality raw materials, machines etc. but the quality of the product is not assured unless, you have good workers engaged in the production process. Staffing thus, as a function, is very important as it is through this process that we get right persons for the organisation and ensure that they stick to the organisation. The benefits of good staffing are as follows.

(a) It helps in getting right people for the right job at the right time. The function of staffing enables the manager to find out as to how many workers are required and with what qualifications and experience.

(b) Staffing contributes to improved organisational productivity. Through proper selection the organisation gets quality workers, and through proper training the performances level of the workers can be improved.

(c) It helps in providing job satisfaction to the employees keeping their morale high. With proper training and development programmes their efficiency improves and they feel assured of their career advancements.

(d) Staffing maintains harmony in the organisation. Through proper staffing, individuals are not just recruited and selected but their performance is regularly appraised and promotions made on merit. For all these, certain rules are made and are duly communicated to all concerned. This fosters harmony and peace in the organisation.

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Staffing as a Part of Human Resource Management

Human Resource Management (HRM) is a broad concept, whereas staffing is a part of it. HRM is the art of procuring, developing and maintaining suitable persons to achieve the goals of an organisation in an effective way. It is the way of optimising human competence at the workplace so that the goals of an organisation are accomplished effectively.

Human Resource Management is that part of management process which develops and manages the human element of the enterprise considering their knowledge, skills, creative abilities, talents and potential for contributing to the organisational objectives. HRM is a broader concept.

Human Resource Management includes human resource planning, recruitment, selection, placement and training of workers, performance appraisal, motivation of work force, remuneration of workers, welfare of employees etc. So staffing is a part of human resource management.

12.3 PROCESS OF STAFFING

The process of staffing starts with ascertaining the required number of various categories of employees for the organisation. This is known as manpower planning. It decides the kinds of staff and the number of staff required for the organisation. This is done through several methods like job analysis, workload analysis, etc. The next thing to be done in the staffing process is the recruitment exercise, i.e., finding out the available manpower from internal and external sources. The next step is to select the right person from the available manpower through tests and interviews and make appointments. This is followed by their placement on the jobs and necessary introduction of the work environment and the rules of compensation, promotion, transfer etc. Thus, the various steps involved in the process of staffing are as follows.

(a) Manpower Planning

(b) Job Analysis

(c) Recruitment

(d) Selection

(e) Placement

(f) Induction

(g) Training and Development

(h) Performance Appraisal

(i) Compensation

(J) Promotion and Transfer

Let us now discuss these aspects briefly to gain more clarity.

12.3.1 Manpower Planning

Manpower planning refers to the process of estimating the manpower requirement of an organisation. While estimating the manpower requirement, the management generally

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keeps in mind the available infrastructure including the technology, production schedule, market fluctuation, demand forecasts, government's policies and so on. It tentatively decides the kinds of staff as well as the number of staff needed for the organisation. The focus of the manpower planning is to get right number of qualified people at the right time.

12.3.2 Job Analysis

In the context of recruitment, one must be conversant with another important aspect of manpower planning viz, job analysis, which is a pre-requisite for any recruitment exercise. The job analysis helps in determining the qualifications, skills and experience required for various categories of employees. It involves:

(i) identification of each job in terms of duties and responsibilities, (called job description) and

(ii) determining the abilities and skills that are required for performing the job (called job specification).

These two aspects of job analysis (job description and job specification) are useful in recruitment and selection of employees so as to find the right person for the job.

INTEXT QUESTIONS 12.1

1. Write true/false against each of the following:

   (a) Staffing is just determining the number of people required in the organisation.

   (b) Determining the size and categories of personnel required is called human resource planning.

   (c) Staffing is a one-time process as people have to be appointed only once.

   (d) Staffing includes human resources management.

   (e) The management function which helps in getting the right persons for the organisation and ensuring that they stick to the organisation is called staffing.

2. Match the following:

(a)	Job analysis	(i)	Determining the size and categories of personnel required
(b)	Job description	(ii)	Determining the qualifications, skills and experience of the employees required for various categories of employees.
(c)	Job Specification	(iii)	Determining the abilities and skills required for performing the job.
(d)	Human resource	(iv)	Identification of the job in terms of duties and planning responsibilities.

12.3.3 Recruitment

Suppose you want to open a restaurant. After planning and organising you are aware of the various job positions that are required to be filled up. Let us say, you have assessed your requirement for a general manager, a chef, an accountant, and many other staff for home delivery of foods. Possibly, you have a list of persons interested to join your restaurant. For example, your uncle has promised you to provide an experienced general manager. The manager of the bank from where you have taken loan has referred an accountant to you. One of the chief cooks of a reputed hotel has already approached/talked to you to join your restaurant as a chef. In addition to all these, you know that there is an office that can provide you people of your requirement by charging a fee, whenever you ask for it. You also know that an advertisement in the newspaper can help you in getting applications from many people. While engaging yourself into all these activities you are basically trying to make a pool of suitable/ interested applicants for the job. In other words you are recruiting the staff for your business.

The term recruitment is often used to signify employment. It is true that normally when we say we have recruited such and such persons, it signifies that we have employed them. But as a part of staffing function, the term recruitment has limited scope. It just refers to one of the initial steps in employment of people i.e., searching for suitable candidates for the various job positions to be filled up from time to time in the organisation. Thus, **recruitment is the process of finding and attracting suitable applicants for employment**.

Sources of Recruitment

Having determined the qualification and experience required for various jobs involved, one has to search for the suitable persons and receive their applications. For this purpose one has to have an idea as to where such persons are available. In other words, one must be aware of the sources of recruitment before publicising the specific staffing needs and induce the suitable persons to apply for the job positions involved. These sources can be internal and external.

(A) Internal Sources : In any business, existing employees expect that they will have chances of promotion and will be considered for higher positions before outsiders are considered. Managers, therefore may promote and transfer some of the existing employees to fill the vacant positions. The advantage of internal recruitment is that it is easier for managers to fill vacancies as they are conversant with the abilities and skills of their subordinates and have records of their performances. Employees also feel happy as their work performance is recognised by management through promotion. However, there is one major drawback of recruitment through internal sources i.e., the organisation is deprived of the benefit of inducting fresh blood into its system.

(B) External Sources : All vacancies cannot be filled up from within the organisation. Existing employees may lack the required skill, initiative and qualification needed for the jobs involved. Hence managers have to recruit some persons from outside the organisation. Not only that the external recruitment provides a wide choice from among a large number of external candidates from which employees may be recruited. The workers and office employees at the lower level are often recruited from outside the organisation. The various external sources of recruitment are as follows :

(a) **Media Advertisements :** You must have seen advertisements in newspapers about vacancies in organisations. The advertisement contains details about the job, its nature, the qualification required to do the job, how to apply, etc. This is a very popular medium of advertising. The job advertisements are also given in magazines, specialised employment magazines like Employment News, Rozgar Samachar, etc. Now-a-days we also commonly find such advertisements in various electronic media like television and Internet. Such advertisements normally get a very good response from the prospective candidates.

(b) **Employment Exchanges :** In India, employment exchanges have been set up by the government for bringing together job-seekers and employers who are looking for employees. Those who are in search of employment get themselves registered with the local Employment Exchanges which keep a record of all such persons in detail who require help in finding jobs. The employer informs about the vacancies to the nearest Employment Exchange. The Employment Exchange, in turn, identifies the names of the qualified employment seekers already registered with it, and forwards them to the employer for consideration. Thus, if you are seeking a job after passing the senior secondary examination, it would be better if you get yourself registered with an Employment Exchange. It may forward your name to the prospective employers keeping in view the suitability of the job as per your qualifications.

(c) **Educational Institutions :** Now-a-days, companies/big organisations maintain a close liaison with the universities, vocational institutes and management institute for recruitment of their staff. As and when the need arises, the companies send one or more of their senior executives to the institutions of repute imparting such professional/technical education to students. These executives take the interview of the interested candidates and select the suitable candidates as per their requirement. This process is popularly known as campus interview and is found to be an effective source of recruitment of managers, engineers, technicians etc. for many companies on a regular basis.

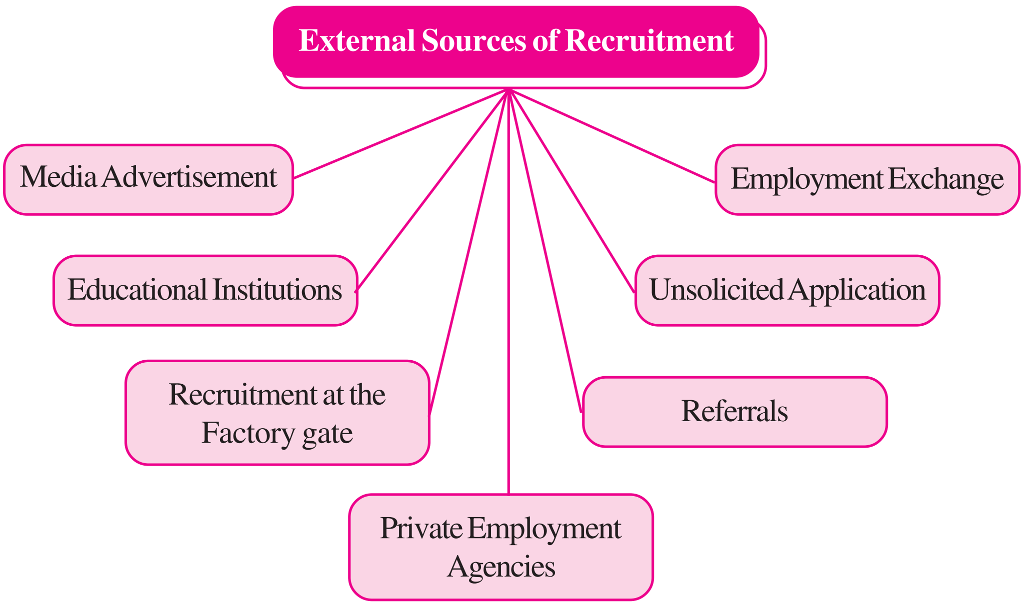
(d) **Unsolicited Application :** Those looking for jobs often apply on their own initiative. They assume that certain vacancies are likely to arise, and apply without references to any job advertisement. Managers keep a record of such applications and contact the suitable candidates when they need them.

(e) **Recruitment at the Factory gate :** This is found mainly in case of factory workers to be recruited on daily wages. Such workers gather in the morning at the factory gate to serve as casual workers. Very often existing regular employees go on leave, and their vacancies are filled up by recruitment at the factory gate. These casual workers having served in the factory for some time may be considered for regular employment at some stage.

(f) **Referrals :** Quite often the management gets references about interested workers from different sources like workers unions, previous employees, existing employees, clients of the organisation etc. These sources are important because their recommendations are made by people who are associated with the organisation and are fully conversant with its requirements.

Sometimes we also receive recommendations from our friends and relatives to employ persons known to them. But one should be very much cautious while considering such recommendations.

(g) **Private Employment Agencies :** In urban areas, a number of private organisations have started functioning as employment agencies. These agencies register with them the names of the individuals who are seeking employment and try to arrange job interviews for such candidates. Companies often get in touch with such agencies to provide them the details of suitable candidates for various jobs.



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INTEXT QUESTIONS 12.2

1. Which one of the following is an internal source of recruitment?
   (a) Media advertising
   (b) Promotion
   (c) Campus interview
   (d) Reference
2. 'Reference' in recruitment refers to:
   (a) Using influence to get the job.
   (b) Referring to the newspaper to find a vacancy.
   (c) Recommendations from different sources.
   (d) Asking for an inter-departmental transfer of an employee.
3. Identify the method of recruitment in which the companies recruit candidates directly from professional or technical institutions.
   (a) Employment exchanges
   (b) Factory gate.
   (c) Media advertising.
   (d) Campus interview

12.3.4 Selection

When an adequate number of applications/names of interested candidates have been collected through the recruitment exercises, the selection process starts. Selection refers to the process of choosing the most suitable person from among the list of interested candidates. It involves going through the qualification and experience of all candidates and matching them with the expectation for the job so as to decide on the most suitable ones for the job. The entire process goes through a number of steps which may be called as selection procedure.

Selection Procedure

As stated above, the selection procedure consists of a number of steps in logical order to identify the candidates who are to be finally appointed. These steps are :

(a) Screening the applications
(b) Holding tests
(c) Selection interview
(d) Checking references

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(e) Medical examination of the candidates

(f) Issue of appointment letter

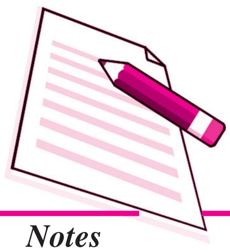
Let us discuss all the steps in brief.

(a) **Screening the Applications :** After receiving the applications from the candidates through recruitment process, the same must be examined to decide which ones deserve to be considered and followed up. Normally, the candidates are asked to apply in their own handwriting on a plain paper. Sometimes the job advertisement mentions the particulars to be given in the application. In many cases the candidates are required to apply in the prescribed form of the company, containing particulars of name, address, nationality, religion, mother tongue, date and place of birth, marital status, education and training, employment history, references etc. Screening exercise involves checking the contents of the applications so as the ascertain whether or not the minimum eligibility conditions in respect of age, experience, qualifications and skills are fulfilled by the candidates who have applied for the job. Screening is usually done by a senior officer of the company or by a screening committee. The purpose of screening is to prepare a list of eligible candidates who are to be evaluated further. Candidates not eligible are thereby excluded from further consideration.

(b) **Holding Tests :** After screening the applications, eligible candidates are asked to appear for selection tests. These tests are made to discover and measure the skill and abilities of the candidates in terms of the requirements of the job. For instance, if the job of a typist requires a minimum typing speed of 40 words per minute, a test is given to see whether the candidates applying for the job have the required typing speed. Passing the test by a candidate does not mean that he will be employed. It implies that all those who have passed the test are qualified for further processing and those who have failed are not to be considered.

The nature of test depends upon the nature of the job involved. For clerical jobs, for examples, an intelligence and aptitude test may be arranged which may include test of general knowledge, test on quantitative problems, and test of reasoning power and vocabulary. For industrial workers and technical hands, performance tests may be organised. For example, to judge the speed and accuracy of typing, candidates may be given a standard paragraph to type. Similarly, candidates for an auto mechanic job may be asked to replace a piston. This is known as Skill or Trade test. For supervisory and managerial jobs, tests are given to find out the candidate's personality, decision-making abilities, etc.

(c) **Selection Interview :** Interview is the most important part of the selection procedure. It serves as a means of checking the information given in the application form and making an overall assessment of the candidate's suitability for the job. In



Notes

an interview, the candidate has a face-to-face interaction with the employer or representatives of the employer, where they try to judge the ability of the candidates. They also get an opportunity to go into the details of the candidate's background which helps a lot in assessing the candidates suitability.

(d) **Checking of References :** In addition to the requisite educational qualification, skill and experience, it is expected that the candidates who are to be considered for employment must have other qualities like balanced temperament, honesty, loyalty, etc. These qualities cannot be judged on the basis of any test. Therefore, information is obtained and verified from the heads of educational institutions where the candidates have studied, or from the persons whose names are given by the candidates as referee, or from their previous employers. For certain jobs, like the job of a cashier or a security guard, reliability is very important job requirement. Therefore, references are required to be contacted to ensure that persons can be relied upon. In case of experienced employees their previous employers can also be contacted for this purpose.

(e) **Medical Examination :** Candidates finally selected for the job are asked to undergo medical examination to see whether the selected candidates are physically fit for the job. A proper medical examination ensures higher standard of health of the employees and their physical fitness which, in turn, reduces the labour turnover, absenteeism and accidents.

The medical examination would also reveal whether he/she suffers from any illness which can be cured e.g., poor eyesight etc. Medical test is essential for certain types of jobs as in the case of police and army, where physical fitness is very important. For certain categories of jobs like the job of driver, proper eyesight is very much essential.

(f) **Issue of Appointment Letter :** Candidates finally selected are offered to join the organisation for which a formal appointment letter is issued containing the nature of job, the remuneration, pay scale, and other terms and conditions relating to employment. Usually a reasonable time is given to the candidates to join the organisation.

Probation period: In most of the organisations the candidates are not initially appointed on permanent basis because it is considered better to try them for a few months on the job itself. This period of service is known as the period of probation. It is necessary because no procedure of selection can fully establish the qualities of a selected candidate. It is only by observing a person at work that one can find out how he performs and also how he behaves with his superior and fellow employees. If during the probation period, his performances not found satisfactory, his period of probation may be extended. The management may also transfer him to some other job at which he may be expected to do better.

Though a number of steps in the selection procedure have been listed, all the steps need not be followed in all cases. For example, for employing casual workers on daily wages, simply an interview by a company's officer is sufficient. Whereas for the job of a typist or clerk, screening of applications, holding tests and interview will be essential. Similarly, for the job of a cashier, checking of references may also be needed.

Difference between Selection and Recruitment

We have noted recruitment and selection are the two essential components of the staffing process. While the recruitment helps in attracting suitable candidates, selection helps in finding out the candidates who meet the requirements of the job. These are closely inter-connected activities. However, recruitment and selection differ in certain respects. While the recruitment refers to the process of attracting good applicants for jobs, selection identifies the most suitable amongst the applicants. In the recruitment process, the effort is to attract the candidates as many as possible and it is regarded as a positive process. But, selection is a negative process as it involves rejection of many candidates. Recruitment involves decisions as regard to the sources of potential candidates. Selection is made through different steps in the procedure adopted. Recruitment helps the manager to attract good candidates, the selection leads to making the right choice.

12.3.5 Placement

If the selected candidate decides to join the organisation, he/she has to report to the concerned authority and formally joins the organisation by giving his consent in writing. Then he/she is placed to perform specific job. Thus, placement refers to selected candidate's joining the positions in the organisation for which they have been selected. The appointment of every candidate is followed by a record of particulars of employment. Such records is properly maintained and described as employment record. It serves a useful purpose on many occasions like selection of employees for training, promotion, increments etc.

12.3.6 Induction

Induction is the process of introducing new employees to the organisation. The new employees should know under whom and with whom he/she is to work, get acquainted and adjusted to the work environment, get a general idea about the rules and regulations, working conditions etc. Usually the immediate supervisor of the new employee introduces him to his work environment. A proper induction programme is likely to reduce his anxiety on how to cope with the work and how to become part of the organisation and helps in development of a favourable attitude towards the organisation and the job.

INTEXT QUESTIONS 12.3

1. Identify the following:
   (a) The process of choosing the most suitable person from among a list of interested candidates.
   (b) Letter issued to the selected candidate.
   (c) Tests organised for industrial/technical workers.
   (d) Face to face interaction of the candidate with the employer or his representatives.
   (e) The examination which the candidates finally selected for the job are asked to undergo.
   (f) The period of service for which the candidates are not appointed on a permanent basis but tried for a few months on the job.
   (g) The process of familiarising the new employees with the new job.
2. Fill in the blanks with the words 'selection' or 'recruitment'.
   (a) ________________ is the process of attracting applicants for the job while ______________ starts only after applications have been received.
   (b) ___________________ is a negative process while ____________________ is a positive process.
   (c) ___________________ helps the managers to attract good candidates while _____________ requires making the right choice.
   (d) _________________ is made through different steps in the procedure adopted.

12.3.7 Training and Development

Helping the employees to improve their knowledge and skill so as to be able to perform their tasks more efficiently is known as training. It is an organised activity for increasing the knowledge and skills of people for a specific purpose. The term 'development' refers to the process of not only building up the skill and abilities for specific purpose but also the overall competence of employees to undertake more difficult and challenging tasks. It is generally used with reference to the training of managers and executives.

Training and Development

Training is an act of increasing the knowledge and technical skills of an employee for doing a particular job efficiently.

Development refers to the learning opportunities designed to help employees to grow. It involves growth an individual in all areas. Development help workforce to improve technical skills, problem solving skills and decision making skills.

Training is necessary for new employees as well as the existing employees for improving their performance at work. For new employees, training is necessary to help them get acquainted with the method of operation and skill requirement of the job. For existing employees, training at periodical intervals is helpful for learning better ways of doing the work, and also as and when they have to undertake new jobs. Thus, training helps employees to improve their knowledge and skill and make them perform their tasks more efficiently. It also helps them in promotion and improves their attitudes and confidence levels.

Importance of Training and Development

Benefits of training for organisations

1. Less wastage, as a trained worker takes less time in learning and doing a job.
2. Better employee performance leading to higher profits.
3. Better utilisation of men, machines and materials.
4. Develop positive attitude in the mind of workers and motivate work force to take new ventures.
5. Reduce labour turnover and absenteeism.
6. Trained worker will adopt fast to the environmental changes compared to untrained worker.

Benefits of Training to the Employee

1. Improved skills acquired from training bring better career options for workers.
2. Better performance by the worker help him to earn more.
3. Trained worker will have better awareness to handle problems and he will be capable to deal with complex type of work.
4. Training increases the moral of workforce.

Methods of Training

There are different methods of giving training to the employees which can be divided into two broad categories.

(1) On-the-Job methods, and

(2) Off-the-Job methods.

1. **On-the-Job methods :** In these methods, the employees learn about their jobs while doing the work duly assisted by their supervisors or seniors. These methods encourage self-learning through practice. Job instruction or coaching, and job rotation, learning while working as an assistant to a senior, understudy positions, temporary promotions are some of the common methods of on-the-job training.

2. **Off-the-Job methods :** These methods involve training employees away from the work place so that experts may conduct the training and employees are free from immediate pressure of completing the jobs at hand. Lectures with demonstration, conferences, case discussions, video shows and films are some of the common methods used as off-the-job training methods. Then, there is another off the job method of training called vestibule training. The vestibule training refers to the training in specially designed workshops in which an attempt is made to duplicate as closely as possible the actual conditions of the work place. In such workshops a large number of employees can be trained in a relatively short period of time.

Difference between Training and Development

Training	*Development*
1. Training is concerned with teaching technical skills only.	1. Development is concerned in teaching technical, human and conceptual skill.
2. It is suitable for technical staff.	2. It is suitable for managerial staff.
3. It is a short term process.	3. It is a long term process.
4. It teaches technical skills and is meant for non-managerial personnel.	4. It teaches concepts & human skills and meant for managerial personnel.
5. Develop already possessed qualities.	5. Develop hidden qualities and talent of personnel.

INTEXT QUESTIONS 12.4

1. Identify the learning opportunity designed to improve skills and abilities of employees.

   a) training   b) development   c) recruitment   d) selection

2. Some learning opportunity in X Ltd. help in the growth of individuals in all respects. Identify it.

   a) training   b) development   c) selection   d) recruitment

12.3.8 Performance Appraisal

In simple words, performance appraisal means judging the performance of employees. Specifically, it means judging the relative abilities of employees at work in a systematic manner. This enables managers to identify employees who are performing the assigned work satisfactorily, and those who are not able to do so, and why. To be fair, performance appraisal needs to be carried out using the same methods and keeping in view uniform standards of work. Generally it is the responsibility of supervisors to carry out performance appraisal of their subordinates, and report it to their own superiors. He may also have to identify the causes of the performance especially if it has fallen short of the expected performance.

The standard of performance or the expected level of performance of an employee on a job forms the basis of judging how well the employee has performed, and whether one employee is more efficient than the other in doing a similar job. The yardstick placed may be the desired quantity of output, the quality of work done, minimisation of wastage of materials caused in the process of work etc. The choice depends upon the type of job involved. However, where quantity or number of units produced or wastage of materials form the basis of appraisal, it is likely to be more accurate. On the other hand, quality of work done may be difficult to measure and hence performance appraisal may not be very accurate.

12.3.9 Compensation

Compensation is one of the most important factors influencing relations between management and the workers. No organisation can attract and retain qualified employees without offering them a fair compensation.

The term 'compensation' refers to a wide range of financial and non financial rewards to the employees for services rendered to the organisation. It includes wages, salaries, allowances and other benefits which an employer pays to his employees in consideration for their services. Compensation may be divided into two categories:

(a) Base/primary compensation.

(b) Supplementary compensation.

Base or primary compensation is a fixed amount paid every month to an employee. It includes wages, salary and allowances paid to an employee irrespective of his performance.

Supplementary compensation refers to the compensation paid to the employees to motivate them to work more efficiently. It is also known as incentive compensation. The incentives may be monetary or non-monetary. The monetary incentives include bonus, commission sales, or profit sharing plans. The non-monetary incentives, on the other hand, include cordial relations with the supervisor, assignment of challenging jobs, recognition etc. Such incentives help the employees to sustain interest in the job and motivates them to work hard. They also provide job satisfaction.

12.3.10 Promotion and Transfer

When an employee is assigned a job involving greater responsibilities, more pay, higher status and prestige than his/her present job, it is known as promotion. Thus, promotion refers to the advancement of an employee to a higher level or position. The main purpose of promotion is to make fuller use of the abilities of a person and also increase his job satisfaction. The basis of promotion may be seniority in service or merit, that is, superior abilities of the employees, or it may be seniority and merit, that is, merits being the same, one who is senior, is considered for promotion. When the performance of an employee is not satisfactory and it cannot be improved, he may be assigned a job of lower rank carrying lower status and pay. This is known as 'demotion'.

Transfer refers to a type of job change where an employee is assigned a different job of the same rank and pay, or when an employee is assigned a similar job in another unit of the firm. Thus, transfer does not usually involve any increase in pay or a superior status. It may be done simply to enable the employee to gain wider experience, or to give him greater job satisfaction, or to balance the requirements of staff in different units.

INTEXT QUESTIONS 12.5

1. Rewrite the following sentences, if found incorrect.

   (a) Training is necessary for only the new employees.

   (b) Promotion makes an employee eligible for training.

   (c) Off the job methods encourage self learning through practice.

   (d) Training of employees away from the place of work is called 'on the job' training methods.

   (e) Transfer refers to a type of job change with higher pay.

WHAT YOU HAVE LEARNT

Staffing refers to the managerial function of employing and developing human resources for carrying out the various activities in an organisation. It helps in getting right persons for various jobs in the organisation and ensures that they have job satisfaction and work in harmony for achievement of organisational goals. The staffing process involves the following steps.

- **Manpower Planning :** The process of estimating the manpower requirement of an organisation.

- **Job Analysis :** The process of determining the qualifications, skills and experience required for various categories of employees.
- **Recruitment :** The process of finding and attracting suitable applicants for employment for various activities of the organisation using the internal as well as the external sources.
- **Selection :** The process of choosing the most suitable persons from among the list of interested candidates. This involves screening the applications, holding tests, interviews, checking references, conducting medical examinations and issuance of appointment letters.
- **Placement :** The process of making the selected candidates to join the specific job positions.
- **Induction :** The process of introducing the new employees to the work environment in the organisation and acquaint them with the rules and regulations, work conditions, etc.
- **Training and Development :** The process of improving the knowledge and skills of the employees to enable them to perform their jobs more efficiently. The methods used may be on the job and off the job.
- Human resource management is a broader concept staffing is one part of HRM. HRM includes stafing, training, development and motivation of workers.
- Training is concerned with teaching technical skill. Development is concerned with teaching human and conceptual skill.
- Less wastage, better employee performance, better utilisation of men, reduced labour turnover are the benefits of training from organisational point of view.
- Improved skills, better employee performance, increased capability, increased moral etc. are the benefits of training to workers.
- Performance Appraisal: Assessing the performance quality of the employees.
- **Compensation :** Determining the remuneration to be given to employees including incentives, if any.
- **Promotion :** Advancement of employees to higher level or position.
- **Transfer :** A type of job change where an employee is assigned a different job with same rank and pay.

KEY TERMS

Compensation	Manpower planning	Promotion
Development	Off-the job training	Recruitment
Induction	On-the-job training	Selection
Job analysis	Performance appraisal	Training
Job description	Placement	Transfer
Job specification		

TERMINAL EXERCISE

Very Short Answer Type Questions

1. What is meant by manpower planning?
2. Distinguish between job description and job specification.
3. List any four sources of external recruitment.
4. State the meaning of selection.
5. What is meant by Promotion?
6. Out of human resource management and staffing which one is wider?
7. Name the term used for equipping the workers with the required skill to perform the job.

Short Answer Type Questions

8. Explain the meaning of the term 'Staffing'.
9. Define the term 'Recruitment'.
10. State the various advantages of internal recruitment.
11. What is meant by 'Induction'?
12. State the importance of training.
13. State any two points of importance of training.
14. How training benefit the employees of an organisation.
15. What is meant by training?

16. What is meant by development?

17. 'Training is beneficial to the organisation'. Comment.

Long Answer Type Questions

18. Describe the importance of staffing.

19. Explain the role of Employment Exchange as source of external recruitment.

20. Briefly describe the various steps involved in the selection process.

21. Distinguish between selection and recruitment.

22. What is meant by training? Explain the different methods of training.

23. Differentiate Training and Development.

24. Discus the importance of training.

ANSWERS TO INTEXT QUESTIONS

12.1 1. (a) False. (b) True. (c) False.
(d) False. (e) True.

2. (a) (ii); (b) (iv); (c) (iii); (d) (i).

12.2 1. (b); 2 (c); 3 (d)

12.3 1. (a) Selection; (b) Appointment letter; (c) Performance tests;
(d) Interview; (e) Medical examination; (f) Period of probation;
(g) Induction/orientation.

2. (a) Recruitment; selection (b) Selection; recruitment
(c) recruitment; selection (d) selection

12.4 1. (a) 2. (b)

12.5 1. (a) Training is necessary for new employees as well as existing employees.

(b) Training makes an employee eligible for promotion.

(c) On the job methods encourage self learning through practice.

(d) Methods of training of employees away from the place of work are called off the job training methods.

(e) Transfer refers to a type of job change with same rank.

Notes

DO AND LEARN

Find out various factories operating in your neighborhood. Visit one of these in the morning when it opens and talk to the workers who assemble outside and waiting to work there on daily wages. Which method of recruitment is it? Ask them if they have any chance of being absorbed in the same factory after some time?

ROLE PLAY

Aman Saxena has graduated from one of the good colleges and is looking for a job. He asks his uncle, who runs a placement agency, to get assistance from him.

Aman	:	Good Morning Uncle! Here I am. You told me that you will help me to find a job after I complete my graduation.
Uncle	:	Yes, sure. I will register your name in my agency.
Aman	:	How does that help?
Uncle	:	There are many companies who get in touch with us. We register names of job seekers and arrange for interviews for such candidates as per their qualifications.
Aman	:	So, is that enough? Do I need to do anything else?
Uncle	:	Yes, there are various other options also which can help you to find a suitable job.

(Choose one of the above roles for you and let one of your friends play the other role. Continue the conversation and explore various ways of recruitment.)

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13

DIRECTING

The managerial function of directing is like the activities of a teacher in a classroom. In order to teach, a teacher has to guide his students, maintain discipline, inspire them and lead them to the desired goal. It is a very important function in the management of any enterprise. It helps the managers in ensuring quality performance of jobs by the employees and achievement of organisational goals. It involves supervision, communication and providing leadership to the subordinates and motivating them to contribute to their best of capability. In this lesson we shall learn about this function in detail.

OBJECTIVES

After studying this lesson, you will be able to:

- state the meaning and importance of directing function;
- identify the elements of directing;
- describe the meaning and importance of communication;
- state the different types of communication;
- explain the meaning, functions and importance of supervision;
- describe the meaning and importance of motivation;
- state the various ways of motivation;
- explain the meaning and importance of leadership and
- identify the qualities of a good leader.

13.1 MEANING OF DIRECTING

While managing an enterprise, managers have to get things done through people. In order to be able to do so, they have to undertake many activities, like guide the people who work under them, inspire and lead them to achieve common objectives. An office manager, for instance, has to supervise the activities of his subordinates, i.e., typists, office assistants, dispatchers, accounts clerks, etc. He has to issue instructions to them and describe and illustrate the work and related activities. He has to tell them what to do, and how to do it. The office manager can plan, organise and appoint people, but he can not get things done, unless he assigns specific duties to his subordinates and motivates them to perform well. All these activities of a manager constitute the directing function.

Thus, directing is concerned with instructing, guiding, supervising and inspiring people in the organisation to achieve its objectives. It is the process of telling people what to do and seeing that they do it in the best possible manner. The directing function thus, involves:

- telling people what is to be done and explaining to them how to do it;
- issuing instructions and orders to subordinates to carryout their assignments as scheduled;
- supervising their activities;
- inspiring them to meet the mangers' expectations and contribute towards the achievement of organisational objectives; and
- providing leadership.

Managers plan and take decisions. They organise to define the work and create suitable positions in the enterprise. People are employed to perform the jobs, but the actual work of getting the job done comes under the directing function. Thus, directing is 'management in action'. It is through the exercise of this function that managers get things done through people.

13.1.1 Importance of Directing

Plans remain mere plans unless they are put into action. In the absence of direction, subordinates will have no idea as to what to do. They will probably not be inspired to complete the job satisfactorily. Implementation of plans is, thus, largely the concern of directing function. As a function of management, directing is useful in many ways.

- It guides and helps the subordinates to complete the given task properly and as per schedule.
- It provides the necessary motivation to subordinates to complete the work satisfactorily and strive to do them best.
- It helps in maintaining discipline and rewarding those who do well.
- Directing involves supervision, which is essential to make sure that work is performed according to the orders and instructions.

- Different people perform different activities in the organisation. All the activities are interrelated. In order to co-ordinate the activities carried out in different parts and to ensure that they are performed well, directing is important. It thus, helps to integrate the various activities and so also the individual goals with organisational goals.
- Directing involves leadership that essentially helps in creating appropriate work environment and build up team spirit.

13.1.2 Elements in Directing

Communication, Supervision, Motivation and Leadership are the four essential elements of directing. In the subsequent sections we shall discuss about the nature and significance of each of these components.

INTEXT QUESTIONS 13.1

1. Define the term 'Directing'.
2. Complete the following incomplete words by taking clues from the statements given for each. Every blank represents one letter only.

   (a) D __ __ E __ T __ __ G

   (b) __ E A __ __ R __ __ I P

   (c) M __ T __ V __ __ I O __

   (d) S U __ __ R __ __ S __ O __

Clues:

(a) It guides and helps the subordinates to complete the given task properly and as per schedule.

(b) It helps in creating appropriate work environment and build up team spirit.

(c) It makes sure that work is performed according to the orders and instructions.

(d) It ensures that work is done according to orders and instructions.

13.2 COMMUNICATION

Communication is a basic organisational function, which refers to the process by which a person (known as sender) transmits information or messages to another person (known as receiver). The purpose of communication in organisations is to convey orders, instructions, or information so as to bring desired changes in the performance and or the attitude of employees. In an organisation, supervisors transmit information to subordinates. Proper communication results in clarity and securing the cooperation of subordinates. Faulty communication may create problems due to misunderstanding between the superior and subordinates. The subordinates must correctly understand the message conveyed to them.

Thus, in communication:

- there are two parties, one is known as the sender and the other is known as receiver;
- there is a message sent by the sender to the receiver; and
- the receiver receives the message and understands it.

Communication does not always flow from supervisor to subordinate. It can also be from a subordinate to a supervisor. For example, subordinates can pass information to the supervisor about the faults/problems at the assembly line. Thus, it is a two way process.

13.2.1 Importance of Communication

Communication in organisations is so important that it is said to be the lifeblood of the organisation. Success of direction largely depends on how effectively the manager can communicate with his subordinates. Proper communication in organisations at all levels and between all levels can improve both the quantity and quality of output. Some of the benefits of communication are as follows:

- Communication helps employees to understand their role clearly and perform effectively.
- It helps in achieving co-ordination and mutual understanding which in turn, leads to industrial harmony and increased productivity.
- Communication improves managerial efficiency and ensures cooperation of the staff.
- Effective communication helps in moulding attitudes and building up employees' morale.
- Communication is the means through which delegation and decentralisation of authority is successfully accomplished in an organisation.

13.2.2 Types of Communication

In an organisation communication can be made from supervisor to subordinate, from subordinate to supervisor and also between two supervisors at the same level. Communication can be done orally or in writing or even through gestures. Communication may be made through formal or informal channels. Thus, the various types of communication are as follows.

On the basis of channel used	On the basis of direction	On the basis of mode used
(i) Formal (ii) Informal	(i) Upward (ii) Downward (iii) Horizontal (iv) Diagonal	(i) verbal - (a) oral, (b) written (ii) Non-verbal (gestural)

Let us now discuss these briefly.

(a) Formal and Informal Communication

The path through which information flows is called channel of communication. In every organisation we have both formal and informal channels. The paths of communication which are based on relationship established formally by management are the formal channels. For example, the General Manager communicates a decision to the production manager who may then issue orders or instructions to the foremen. It may also be like a worker applying to his supervisor for a loan from the GPF account. He/she forwards it to the Manager Accounts who finally sends it to the General Manager (Finance) for approval.

Communication, which takes place on the basis of informal or social relations among staff, is called informal communication. For example, any sharing of information between a production supervisor and an accountant, as they happen to be friends or so. Mostly informal channels are used due to friendly interaction of members of an organisation. In fact, it may be purely personal or related to organisational matters.

(b) Upward, Downward, Horizontal and Diagonal Communication

On the basis of the flow or direction of communication in organisations, it can be classified as upward, downward, horizontal or diagonal. When employees make any request, appeal, report, suggest or communicate ideas to the superior, the flow of communication is **upward** i.e., from bottom to top. For instance, when a typist drops a suggestion in the suggestion box, or a foreman reports breakdown of machinery to the factory manager, the flow of communication is upward. Upward communication encourages employees to participate actively in the operations of their department. They get encouraged and their sense of responsibility increases when they are heard by their supervisors about problems affecting the jobs.

When communication is made from superiors down the hierarchy it is called a downward communication. For instance, when superiors issue orders and instructions to subordinates, it is known as downward communication. When the General Manager orders supervisors to work overtime, the flow of communication is downward i.e., from top to bottom. Similarly, communication of work assignments, notices, requests for performance, etc. through bulletin boards, memos, reports, speeches, meetings, etc, are all forms of downward communication.

Communication can also be amongst members at the same level in the organisation. For instance, production manager may communicate the production plan to the sales manager. This is known as **horizontal flow of communication**. Here, the communication is among people of the same rank and status. Such communication facilitates coordination of activities that are interdependent.

When communication is made between people who are neither in the same department nor at the same level of organisational hierarchy, it is called **diagonal communication**. For example, cost accountant may request for reports from sales representatives not the sales manager for the purpose of distribution cost analysis. This type of communication does take place under special circumstances.

(c) Verbal and Non-verbal Communication

On the basis of the mode used, communication may be verbal or non-verbal. While communicating, managers may talk to their subordinates either face to face or on telephone or they may send letters, issue notices, or memos. These are all verbal communication. Thus, the verbal modes of communication may be oral and written. Face to face communication, as in interviews, meetings and seminars, are examples of oral communication. Issuing orders and instructions on telephone or through an inter-communication system is also oral communication. The written modes of communication include letters, circulars, notices and memos. Sometimes verbal communication is supported by non-verbal communication such as facial expressions and body gestures. For example – wave of hand, a smile or a frown etc. This is also termed as the gestural communication.

Barriers to Effective Communication

Barrier means the hindrance that adversely affect communication. These barriers have been discussed under the following categories :

A. Semantic Barriers

These barriers take place when the sender and the receiver of the message interpret the words, sentences, symbols etc. differently.

1. **Symbols with different meanings :** A word may have different meanings. For example minute (time & small).

2. **Badly Expressed Message :** Same time manager may use wrong words. Manager may omit needed words.

3. **Faulty translation :** A manager receives information from his superior and transfers it to its subordinates. Manager translates it for all the employees according to their levels of understanding. If the receiver of information makes a faulty translation, it can be a barrier in the communication.

4. **Un clarified Assumptions :** Same times a sender takes it for granted that the receiver knows same basic things. So sender may communicate him only about the major subject matter. This may be a barrier in effective communication.

B. Psychological Barriers

Psychological barriers appear because of the state of mind.

1. **Lack of Attention :** When the receiver is engaged in some important work he does not listen to the message attentively. This lack of attention will be barriers to effective communication.

2. **Loss by Transmission and Poor Retention :** When communication passes through various levels, successive transmissions of the message may result in loss of information.

3. **Premature Evaluation :** Sometimes the receiver of information makes a judgment before listening to the entire message. This is a hindrance in the exchange of information.

4. **Distrust :** If the receiver and sender of information do not trust each other, they cannot understand each other's message in its original sense.

C. Organisational Barriers

Some organisational or physical barriers put difficulties in smooth communication. These are :

1. **Rules and Regulations :** Rigid rules may lead to red tapism, delay in action and delay in movement of information.

2. **Status :** Sometimes higher managers in the higher rank may not pass on all information to the managers of lower ranks.

3. **Organisational Policies :** Organisational policies determine the relationship among all the persons working in the organisation. For example in centralised organisation, all important information is retained at the top level officers only.

4. **Complexity in Organisational Structure :** In an organisation where there are number of managerial levels (complex structure), there will be delay in communication. Information gets changed before it reaches to receiver.

D. Personal Barriers

1. **Fear of Challenge of Authority :** Superiors try to cancel information if they fear of losing their authority over the subordinates.

2. **Lack of Confidence in Subordinates :** Top level officers do not have confidence on the competence of their subordinates. So they may not pay any attention to their advice.

Notes

3. **Unwillingness to Communicate :** Subordinates may not be willing to communicate with their superiors if they believe that it may adversely affect their interests.

4. **Lack of Proper Incentive :** The lack of incentive to the subordinates can be of the fact that their suggestions are not given any importance.

How to Overcome the Barriers

Most of the barriers can be removed and the communication can be made more meaningful and effective if the following points are considered by the manager:

1. **Consult Others before Communicating :** If the subordinates are allowed to participate in the development of the message to be communicated, they will accept it and will have a commitment to implement it. Therefore, it is better to involve others in developing the message.

2. **Communicate According to the Needs of the Receiver :** The sender of message should know the level of understanding of the receiver. The content, language and tone of the message should be adjusted to suit the education and intelligence of the receiver.

3. **Clarify the Idea before Communicating :** The message to be conveyed should be analysed in depth by the communicator. Communicator should be clear of the message to be transmitted and try to pass the message in simple words.

4. **Good Listener :** Managers should attend and listen patiently to the employees. This helps the employees to mingle freely with the managers.

5. **Proper Feedback :** Communication is complete only when the message is understood by the receiver. The communicator can ensure the success of communication by asking questions about the message conveyed. The receiver should be encouraged to respond to the message. Thus communication becomes a two-way process.

6. **Follow up Communication :** Managers should review and follow-up instructions given to subordinates. This follow-up will help to remove misunderstanding of instructions.

7. **Use of Informal Channels :** A manager must make use to his grapevine to support the formal channels of communication.

INTEXT QUESTIONS 13.2

1. Name the parties involved in the process of communication.

2. Classify the following into various types of communication on the basis of channel, direction and mode of communication.
   (a) The General Manager seeking explanation from a supervisor for poor performance in his department.
   (b) The supervisor sending an explanation to the General Manager stating the performance of his department.
   (c) The sales assistants discussing with his friend regarding customers' behaviour.
   (d) A typist informs his fellow typist during the lunch-break about the rude behaviour of her supervisor.
   (e) A boss frowning at his subordinate for a job done wrongly.

13.3 SUPERVISION

After the employees have been instructed regarding what they have to do and how to do, it is the duty of the manager to see that they perform the work as per instructions. This is known as **supervision**. Managers play the role of supervisors and ensure that the work is done as per the instructions and the plans. Supervisors clarify all instructions and guide employees to work as a team in co-operation with others. Supervisors solve most of the routine job-related problems of subordinates. Supervisor, thus, performs the following functions:

- clarifies orders and instructions issued to subordinates and ensures that they have understand and follow these fully;
- ensures that subordinates have the required facilities to perform their jobs;
- keeps a watch and guides the activities of subordinates in performing their jobs;
- broadens the horizon of his subordinates by making them aware of the wider aspects of their day-to-day work;
- coordinates the work of different subordinates under him; and
- detects errors and omissions and ensures their rectification.

Though supervision is required at all levels of management, it is of great importance at the operational level i.e., at the level of first line supervisor. Managers at this level devote maximum time in supervising the work of subordinates. Though the top or middle level managers also supervise the work of their subordinate managers, but it is the first line supervisors who are in direct and constant touch with operatives i.e., workers in the factory and clerical staff in the office. Thus, they are directly responsible for getting the work done through most of the employees in an organisation.

13.3.1 Importance of Supervision

From what has been said about supervision, it must be clear to you that supervision is of great significance in getting the work done as per plans and as scheduled. On the basis of the influence on the work at operational level and human approach to the problems of workers, the supervision can ensure workers cooperation and support in achieving organisational objectives.

Supervisors are the key people among managers at different levels. They are the link between the top and middle management and the workers. Take, for example, the foreman of the factory or the office superintendent in the office. Both of them are members of the management team, and are in direct contact with operatives in the workshop and clerical staff in the office. They are the mouthpiece of management for communicating its ideas, plans and policies to the workers and employees. At the same time, they have to play the role of principal spokesmen of their subordinates to communicate their feelings and grievances to the management. Thus, it is only the supervisor who, as a member of the management team, is capable of developing links to workers. Supervisors are expected to maintain the best and friendly relations with their seniors as well as with the workers and enjoy the trust and confidence of both management and operatives.

13.3.2 Functions of a Supervisor

A supervisor works at the lowest level of management like all other managers he performs the functions of planning, organising, directing and controlling with respect to his own subordinates and department. A major part of his time is devoted in directing and controlling the activities of his subordinates. He also coordinates the activities of his subordinates by integrating the same with the activities of other departments of the enterprise. Besides he performs certain special functions which have been described below :

1. **Link Between Top Management and Workers :** A supervisor works as a link between managers working at higher levels and workers. He conveys the decision of the higher level managers to the workers and also communicates the performance of the workers to the higher level management through different performance reports. He also communicates the grivances, feelings of demands etc. of the workers to the higher level management.

2. **Creating Ideal Atmosphere :** Being an important link between the operatives and the management a supervisor is expected to create an ideal atmosphere for work in the organisation by correctly communicating the ideas, wishes and decisions of the higher level management to the workers.

3. **Guiding the Workers :** For obtaining best results the supervisor assigns jobs to the workers keeping in mind their ability and aptitude for work. He makes them available the necessary tools and equipments, raw materials etc. for proper execution of the jobs. He also guides the worker properly to ensure that the job is done with perfection and accuracy.

4. **Quality Output :** A supervisor has to ensure quality output through constant watch on the performance of workers. He ensures that the performance of the worker takes place as per the plans. This results into study flow of output.

5. **Feedback :** A supervisor keeps on watching the performance of his subordinates and identifies their strengths and weaknesses. He gives the feedback about this to the workers with the object to further improve the performance of the workers in future.

6. **Suggest Training Programmes :** A supervisor identifies the areas in which the workers require training and accordingly suggests training programmes that should be organised for them.

INTEXT QUESTIONS 13.3

1. List any four activities that your friend is expected to do as a supervisor of a publishing house.

2. Answer the following questions.

   (a) Who puts plans of the management into action?

   (b) Who clarifies the instructions and guide employees in their work?

   (c) The importance of supervision is very much felt at which levels of management.

   (d) Who provides the necessary linkage between management and workers?

3. Give any three functions to be performed by Supervisor.

13.4 MOTIVATION

Motivation is one of the important elements of directing. Issuance of proper instructions or orders does not necessarily ensure that they will be properly carried out. It requires manager to inspire or induce the employees to act and get the expected results. This is called motivation. It is a force that inspire a person at work to intensify his willingness to use the best of his capability for achievement of specified objectives. It may be in the form of incentives like financial (such as bonus, commission etc.) or, non-financial (such as appreciation, growth etc.), or it could be positive or negative. Basically, motivation is directed towards goals and prompt people to act.

13.4.1 Importance of Motivation

While performing a job, two things are required. The ability to work and the willingness to work. Without willingness to work, ability to work can not produce results. The importance of motivation lies in converting this ability to work into willingness to work. Performance depends on ability as well as willingness; and willingness depends on motivation. Thus, motivation is a key element in directing people to do the job. Some of the other benefits or importance of motivation are:

- with proper motivation there can be maximum utilisation of the factors of production like men, money, material etc.;
- if employees are motivated it will reduce employee turnover and absenteeism;
- motivation fosters a sense of belongingness among the employees towards the organisation and also improves their morale;
- motivation helps in reducing the number of complaints and grievances. The wastage and accident rate also come down and
- with proper motivational techniques, management can attract competent and best skilled employees.

13.4.2 How to Motivate

After learning about the importance of motivation in directing, you must be wondering as to what is normally done to motivate the employees. Actually, there is no hard and fast rule of motivating individuals in a specified way. Not all individuals are motivated in the same way. It varies from individual to individual. However, on the basis of a lot of research done in the field of motivation, the following must be kept in mind while motivating.

Each employee has some needs of his own that he wants to fulfill. While directing, it is essential to ensure that any of the unfulfilled need of the individual is being taken care of. Here we must understand what is a need. A need is a feeling of lack of something and every person tries to take care of that feeling by satisfying/fulfilling what he lacks. For example, when you are hungry, you eat food to satisfy the lack of food. So here hunger is your need. The needs of the individual differ from person to person. However, there are certain common needs which are known to exist in most cases. For instance, people have basic needs like the need for food, clothing and shelter. These are known as **Physiological needs**. People generally work so as to be able to earn money to satisfy such needs. Once the basic needs are satisfied, people wish to satisfy higher category of needs. They want safety and security and desire to be protected against loss of employment, sickness, accident etc. These are known as **Safety and Security needs**. Thereafter, people want to have a sense of belonging to the organisation and to be accepted by fellow workers. These are known as **social needs**. Similarly, there are people who wish to be considered important and expect that their opinions should be recognised by others. These needs are known as **ego needs**. Further, a person may wish to achieve what he thinks is due to him, i.e., he wants to realise his ambition fully. These needs are known as **self-actualisation needs**. This is called hierarchy of needs concept of motivation developed by Maslow.

Maslow's Hierarchy of Needs

According to Maslow, an individual has many needs and their order can be determined. If a person satisfies his first need, then he thinks about his next need. After satisfying the second need, he tries to satisfy third need and so on. So needs are the motivators.

Maslow has given hierarchy of needs in the following ways :

1. **Physiological Needs :** These needs include need for food, shelter and clothing.
2. **Safety and Security Needs :** Once physiological needs are fulfilled then the people start thinking about their safety. Safety needs include need for physical safety and economic safety. Physical safety means safety from accidents, disease etc. Economic safety refers to safety of livelihood.
3. **Social Needs :** Man is a social animal. He wants to live in the society honourably. Therefore, he wants friends and relatives with whom he can share his joys and sorrows. Social needs include need for love, affection, friendship etc.
4. **Esteem Needs :** These are the need for respect and recognition. Esteem needs are also known as Ego needs.
5. **Self Actualisation Needs :** Self actualisation needs are concerned with becoming what a person is capable of becoming. These needs include need for growth, self fulfillment etc.

Assumptions of Maslow's Need Hierarchy Theory

1. Behaviour of people depends upon their needs. Human behaviour can be changed by fulfilling their needs.
2. Generally the needs follow the hierarchy starting them physiological needs.

Financial and Non-financial Hierarchy Theory

Monetary / Financial incentives are directly related with money. Non-financial incentives are not directly related with money.

Following are the financial incentives :

1. **Pay and Allowances :** Salary is the basic monetary incentive of every employee. Salary includes basic pay, dearness allowance etc.

2. **Bonus :** Bonus means the payment to employees in addition to their regular remuneration. Bonus is provided in the form of cash, free trips to resorts or foreign countries etc.
3. **Commission :** In sales department, sales persons get commission on the basis of their sales.
4. **Retirement Benefit :** Every employee is concerned about his future after retirement. Some retirement benefits are Provident fund, Pension, Gratuity etc.
5. **Perquisites :** Rent free accommodation, car allowance, facility of a servant etc. are called as perquisites.

Non-financial Incentives

Besides the financial incentives there are certain non financial incentive that motivate the employees. The important non-financial incentive are given below :

1. **Career Advancement Opportunity :** Appropriate skill development programmes will encourage employees to show improved performance.
2. **Status :** Status means the rank of a person in a organisation. The rank is linked with authority, responsibility and other extra benefits. Everybody has a wish to be in high rank. Therefore an employee can be motivated by placing him in higher rank.
3. **Employee Recognition Programmes :** Every employee wants to be considered as an important part of the organisation. Work of an organisation should be distributed in such a way that every employee feels that his work is yield and he is capable to do that work. This motivates the worker and he works hard and in a responsible manner.
4. **Employee Participation :** It means involving employee in decision making specially when decisions are related to workers.
5. **Organisation Climate :** It means the relationship between superior and subordinates. Employees can put their best if healthy climate exist in an organisation.

It is important to remember that the needs and desires of people change. Once their basic needs are satisfied, other needs arise. Managers have thus, to understand the needs and desires of subordinates and decide how to motivate them.

The knowledge of the different types of need enables a manager to adopt different ways to motivate individuals depending upon which need is unsatisfied for the individual. For example, a person whose physiological needs are not fulfilled may be motivated to work with a promise of increase in pay, whereas another person may be motivated if he is given a very challenging job to perform regardless of the pay.

In fact many other approaches have been developed for motivation. But in simple terms as stated earlier it is usually in the form of incentives. Not only that, certain factors or job conditions that exist in organisations like recognition of work, advancement in career, challenging nature of the work, etc., also motivate the employees.

INTEXT QUESTIONS 13.4

1. Mention any five benefits the management will get if the employees are properly motivated.

2. Match the expressions in Column (I) with those in Column (II):

Column (I)	Column (II)
(a) Employee's needs for food, clothing and shelter	(i) Self-actualisation need
(b) The desire for protection against accident sickness and other future uncertainties	(ii) Ego needs
(c) The need for belonging and acceptance by fellow workers	(iii) Physiological needs
(d) People's desire to be considered important	(iv) Safety and security needs
(e) Employees wish to realise their ambition fully	(v) Social needs

3. Complete the paragraph given below by selecting the appropriate words given here.

(Physiological, security, appreciation, food, friends, recognition)

Govinda is without a job and without a source of income. He is without food. He is starving. In such circumstances, he wants nothing but some (a) ____________. His other (b) ________________ needs are air, water and sleep. Govinda is fortunate and finds a job. He gets his bread, but his work is dangerous and the job is temporary. He now seeks (c) ____________________. His management is sympathetic and assures him of permanent employment. But he is not happy for he feels lonely. Now he begins to look around for (d) _______________. Even if surrounded by loving friends, he is unhappy from within. He now requires some measure of self-confidence and self-respect. He wants to assure himself that he can do difficult jobs and work independently. He now seeks (e) ______________ and (f) _____________ without which he feels uneasy. He now has much self-confidence and self-respect.

Notes

13.5 LEADERSHIP

While motivation is the process through which employees are made to contribute voluntarily to work, leadership is the ability to persuade and motivate others to work in a desired way for achieving the goals. Thus, a person who is able to influence others and make them follow his instructions is called a leader**.** For example, in an organisation the management decides to install some new machines to which the workers are resisting. However, one of the workers takes the initiative, explains the fellow workers the benefits of working with the new machines and moulds them to accept the management's decision. Now he is said to be leader as he is able to influence a group of workers who followed him. In practice, the managers have to guide and lead their subordinates towards the achievement of goals, and so, to be an effective, a manager has to be a good leader

Leadership is the process, which influences the people and inspires them to willingly accomplish the organisational objectives. The main purpose of managerial leadership is to get willing cooperation of the workgroup to achieve the goals.

13.5.1 Importance of Leadership

The objectives of any organisation can only be fulfilled if its employees are working towards accomplishment of such objectives. To make people work in the desired manner, proper instructions and guidance are necessary. And this direction process becomes effective when the persons who give such direction have leadership qualities. Leadership is essential in functioning of any organisation and its importance and benefits are varied. Some of these importances are:

- leadership improves the performance of the employees. Leaders can motivate the followers to work and thereby increase their performance level.
- with continuous support and guidance, leaders are able to build confidence among the followers, thereby increasing speed and accuracy and decreasing wastage.
- with friendly and cooperative efforts the leader is able to build employees' morale which in turn contribute to higher productivity.

13.5.2 Leadership Qualities

In order to be successful, a leader must possess certain qualities. A good leader should be professionally competent, intelligent, analytical and he/she should have a sense of fair play, including honesty, sincerity, integrity, and sense of responsibility. He must possess initiative, perseverance, be diligent and realistic in his outlook. He must also be able to communicate his subordinates effectively. Human relation skills are must for any leader. Earlier, it was believed that the success or effectiveness of a leader depends upon his personal traits or characteristics, like physical appearance, intelligence, self-confidence, alertness, and initiative. This is no longer regarded as a correct approach.

It has been established on the basis of experiments that the success or effectiveness of a person as a leader depends upon his behaviour pattern or leadership style in relation to the followers.

To get things done, managers have to influence their subordinates and seek their voluntary co-operation. If their leadership is not based on suitable behaviour or style, they will not be successful. When leaders involve people in determining goals, and build up team spirit, chances are that people will follow them voluntarily.

INTEXT QUESTIONS 13.5

1. List atleast five important qualities of a good leader.

2. Following are certain statements about a good leader. Rectify if any statement is found to be wrong.

   (a) He is empathetic and listens to others.

   (b) He is competent thus, does everything alone.

   (c) He has to be very good looking else people will not like him.

   (d) He likes to generate team spirit and works with the people as a team.

3. Multiple Choice Questions

   i. Need for food can be included under which class for need?

   a) Physiological needs b) Safety needs

   c) Social needs d) Ego needs

   ii. Ram, a worker in a MNC wants promotion in his job. Which need he wants to satisfy?

   a) Physiological needs b) Safety needs

   c) Self actualisation d) Ego needs

   iii. Balan is working in 'Reliance Company Ltd.' The company gave him and his family a free ticket to a resort in Thailand. State which of the following incentive is used by the company to motivate its worker.

   a) Financial incentive b) Non-financial incentive

   c) Semantic incentive d) None of the above

Notes

iv. 'Maruti Sazuki' started training programme for all its officers. Identify the incentive through which the company tries to motivate the workers.

a) Financial incentive b) Non-financial incentive

c) Semantic incentive d) None of the above

v. A notice circulated in English was poorly translated in Tamil. Name the type of barrier relating to this :

a) Semantic barrier b) Psychological barrier

c) Organisational barrier d) Personal barrier

WHAT YOU HAVE LEARNT

To get things done, managers have to guide people who work under them, inspire and lead them to achieve common objectives. In order to be able to do so, the managers need to communicate job related orders and instructions, supervise subordinates at work, and motivate them. These activities of a manager are known as directing. Directing is thus concerned with instructing, guiding and inspiring people in the organisation to achieve its objectives. Its important components are communication, supervision, motivation and leadership.

- Communication is the process by which a person transmits information or message to another person. The process facilitates the task of issuing orders and instructions to convey the superiors' ideas about the work to be done by subordinates. It also helps in conveying policies, procedures and decisions to employees.
- The flow of communication can either be upward or downward. It can be formal as well as informal. When it takes place among managers of the same rank it is known as horizontal communication. When communication is made between people who are neither in the same department nor at the same level of organisational hierarchy, it is called **diagonal communication**. Communication may be in the form of oral or written or even non-verbal like gestural.
- Supervision involves seeing that subordinates perform the work as per instructions given. Supervisors clarify all instructions and guide people to work as a team in co-operation with each other.
- Though supervision is necessary at all levels of management, it is of great importance at the first level. It is at this level that supervisors are in direct contact with employees.
- Supervisors are in key positions in the hierarchy of management. They act as a link between higher level managers and the workers.

- Inspiring people to work is another important component of the directing function. This is known as motivation. Motivation requires the use of means to fulfill the needs and desires that may inspire individuals to apply their best abilities in work.
- Needs of people differ from individuals to individuals. But there are certain common needs felt by most people such as the physiological needs, need for safety and security, social needs, ego needs, and self-actualisation needs.
- There is no standard way of motivating all types of people. Motivation is need based. Manager has to find out the unsatisfied needs of the employees and accordingly decide to motivate them.
- Motivation helps managers in getting things done more efficiently by the employees. If the employees are motivated, they will fully utilise the production facilities and put in their best efforts in performing the job.
- In order to get things done, a manager has to be a good leader. Leadership is the ability to persuade others to work in a desired way. Thus, a person who persuades others and makes them follow his instructions willingly is called a leader.
- To be a good leader, a person must posses certain qualities like professional competence, intelligence, ability to analyse, honesty, sincerity, integrity etc.
- Supervisor helps in optimum utilisation of resources, creation of more disciplined workforce, control, good communication and proper feedback.
- A manager must understand needs and wants of people if he has to motivate them. Famous psychologist A.W.Maslow developed the following need Hrirarchy theory which contains five types of needs like physiological, safety, social, ego and self-actualisation.
- Physiological needs are the basic needs which must be satisfied before all other needs are satisfied.
- Safety needs can be satisfied by giving job security, pension, insurance etc.
- Social needs include need for love, affection, association etc.
- Esteem needs include need for self confidence, self-respect etc.
- Self actualisation need refers to need to grow and self-fulfillment.
- Incentives are both financial and non-financial.
- Financial incentives include pay and allowances, bonus, commission, retirement benefit etc. Non-financial incentives are career advancement opportunity, status, employee participation and employee recognition programme.

Notes

- Semantic barriers, psychological barriers, organisational barriers and personal barriers are the main barriers to effective communication.
- Clarity, attention, feedback and grapevine can be used to overcome the barriers.

KEY TERMS

Communication	Horizontal	Communication Safety and Security needs
Diagonal Communications	Informal Communication	Self-actualisation needs
Directing	Leadership	Social needs
Downward Communication	Motivation	Supervision
Ego needs	Non-verbal Communication	Upward Communication
Formal Communication	Physiological needs	Verbal Communication

TERMINAL EXERCISE

Very Short Answer Type Questions

1. What is meant by directing?
2. Name the different elements of directing.
3. Define motivation.
4. Who is a leader?
5. List any four qualities of a good leader.
6. State any two functions of a supervisor.
7. What is meant by financial incentive? Give any two examples of financial incentives.
8. Enumerate any two types of non-financial incentives.

Short Answer Type Questions

9. Explain in brief the importance of directing.
10. State the different types of communication on the basis of direction.
11. Explain the functions of a supervisor.

12. Describe the importance of motivation.
13. State the hierarchy of needs concept of motivation as developed by Maslow.
14. Enumerate any five barriers to effective communication.
15. What are semantic barriers of communication.
16. Explain in brief any three types of financial incentives.

Long Answer Type Questions

17. Describe the essential elements of the managerial function of directing.
18. What is communication? Explain how communication is an important element of directing function of management.
19. What is meant by the term supervision in management? Explain briefly the functions of a supervisor.
20. Explain the term leadership and state the qualities of a good leader.
21. "Leadership is considered as the most important element of the directing function of management". In the light of this statement, explain the importance of leadership.
22. What are the functions of a supervisor? Explain briefly.
23. Discuss in detail Maslow's need hierarchy theory of motivation.
24. What is meant by 'Monetary Incentives'? State any five types of monetary incentives. Which contribute to the performance of employees?
25. Explain briefly non-financial incentives used to motivate employees of a company.
26. There are some barriers in communication which are concerned with organisational structure and rules and regulations. State any three such barriers.
27. There are some barriers in communication which are concerned with the state of mind of both the sender and the receiver. State any four such barriers.

ANSWERS TO INTEXT QUESTIONS

13.1 2. (a) DIRECTING (b) LEADERSHIP
(c) MOTIVATION (d) SUPERVISION

13.2 1. (a) Sender (b) Receiver

2. (a) Formal, Downward, Verbal
(b) Formal, Upward, Verbal
(c) Informal, Horizontal, Verbal

(d) Informal, Horizontal, Verbal

(e) Informal, Downward, Non-verbal

13.3 1. (a) Clarify orders and instructions issued to subordinates

(b) Ensure required facilities for the subordinates

(c) Keep a watch and guides the activities of subordinates

(d) Coordinate the work of different subordinates under him

2. (a) Supervisor (b) Supervisor (c) Operational Level

(e) Supervisor

3. (a) Guiding the workers, (b) Provides feedback,

(c) Suggest Training Programmes.

13.4 1. (a) Maximum utilisation of factors of production

(b) Employee turnover and absenteeism will reduce

(c) Develop the sense of belongingness

(d) Less complaint and grievances

(e) Attract competent and quality staff

2. (a) – (iii), (b) – (iv), (c)- (v), (d) – (ii), (e) – (i)

3. (a) Food (b) Physiological (c) Security

(d) love & affection (e) Appreciation (f) Recognition

13.5 1. (a) Competent (b) Intelligent (c) Integrity

(d) Initiative (e) Perseverance

2. (a) Correct

(b) He is competent but can not do things alone

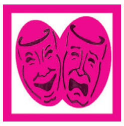
(c) Need not necessarily be good looking

(d) Correct

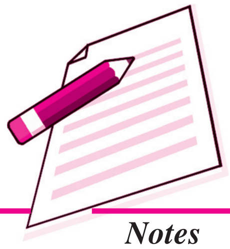
3. (i) a (ii) d (iii) a (iv) b (v) a

DO AND LEARN

Identify atleast 10 different people of your locality and ask them about their needs. Make note of atleast three needs of each individual and classify them in the category suggested by Maslow.



ROLE PLAY



Notes

Madan Mohan, the owner of a shoe factory visited his friend Gyan Prakash who also runs a factory of making kitchen appliances. He found Gyan Prakash sitting with floor workers and taking tea with them. When the workers left, the two friends sat together.

Madan Mohan : Having tea with floor workers!

Gyan Prakash : Yes, I do this exercise once in every fortnight to know their wants, needs and aspirations. I keep my labour force happy.

Madan Mohan : You may do anything, they will neither be happy nor work enthusiastically.

Gyan Prakash : No, on the contrary if you know how to motivate them to work in the required direction, then output will be more than the effort put in.

Madan Mohan : Motivation!

Gyan Prakash : Yes, all human have needs. They may vary from person to person. Fulfillment of these needs can stimulate people to work in the required direction.

(The two friends discussed further about motivation.)

Choose a role for yourself and one for your friend and continue the conversation.

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14

CO-ORDINATION AND CONTROLLING

You have learnt about the various functions of management and gone through the details of planning, organising, staffing and directing functions. In this chapter we shall learn the details of coordinating and controlling functions. You know that the various business activities of an organisation are grouped and carried out by different departments and within each department there are divisions and sub-divisions. In order to achieve the organisational goals effectively, there is need to ensure that activities of such divisions, sub-divisions and departments are harmonised and duly monitored so that the performance of the organisation confirms to the plans and the prescribed time schedule. This can be achieved through proper coordination and control of the activities of all groups. Let us now learn about the concepts of coordination and control and the various steps involved in the control process.

OBJECTIVES

After studying this lesson, you will be able to:

- explain the meaning and significance of coordination;
- explain the meaning of control;
- describe the characteristics of control and the importance of controlling and
- identify the steps involved in the process of control.

14.1 MEANING OF CO-ORDINATION

In every organisation, different types of work are performed by various groups and no single group can be expected to achieve the goals of the organisation as a whole. Hence, it becomes essential that the activities of different work groups and departments should be harmonised. This function of management is known as 'co-ordination'. It

Notes

ensures unity of action among individuals, work groups and departments, and brings harmony in carrying out the different activities and functions so as to achieve the organisational goals efficiently. In other words, coordination is the orderly arrangement of individual and group efforts to provide unity of action in the pursuit of a common goal. In an organisation, for example, the purchase department buys raw materials for production, the production department produces the goods, and the marketing department procures orders and sells the products. All these departments must function in an integrated manner so that the organisational goal can be duly achieved. Thus, coordination involves synchronisation of different activities and efforts of the various units of an organisation so that the planned objectives may be achieved with minimum conflict.

"According to Brech, Coordination is balancing and keeping together the team by ensuring suitable allocation of tasks to the various members and seeing that the tasks are performed with the harmony among the members themselves."

14.2 SIGNIFICANCE OF CO-ORDINATION

The significance of co-ordination as a function of management mainly arises from the fact that work performed by different groups, units or departments form integral part of the total work for which an organisation is established. Without harmonised efforts or unity of action, achievement of goals in some departments may run counter to that of the other departments, or the timing of achievements may not fit in properly. This has to be avoided and the managers have to prevent overlapping and conflict so as to achieve unity of action. With increasing size and scale of operations, the significance of co-ordination becomes more important. This is because of the following reasons -

(a) When there is growth in size and the volume of work, there will be more people and work groups. So there is greater possibility of people working at cross purposes as the unit and sub-unit goals may be considered more important by them than the organisational goals. Not only that, the large size may also lead problems of supervision and communication. Hence coordinating the activities in a large concern becomes a major task for the managers.

(b) Large organisations generally tend to have activities located at different places, which may not permit frequent and close interaction among people. Hence, the need for co-ordination becomes greater and it becomes a major responsibility for the managers.

(c) Growth in size of an organisation is often combined with diversification of business activities. This may be due to new unrelated products being added to the existing products. As a result, there may be more division and sub-division of activities. At the same time, there is an increase in the number of managerial levels and vertical division of responsibilities. All these make coordination more difficult as well as important.

In view of the importance of coordination in an organisation, it is sometimes called the 'essence' of management. It is a function of managers in all departments and branches of an organisation, and applies at all the levels of management. It ultimately helps in reconciliation of goals, total accomplishment of business objectives, maintenance of harmonious relationship between different groups and ensuring economy and efficiency in the organisation.

INTEXT QUESTIONS 14.1

1. Define the term Co-ordination.
2. Correct the following statements, in case found wrong.
   (a) Co-ordination leads to diversity in action.
   (b) The importance of co-ordination is greater in small organisations.
   (c) As work is divided and sub-divided, the necessity of co-ordination is increased.
   (d) Co-ordination is the function of lower level managers only.
   (e) In the absence of co-ordination, organisational goals may be neglected by managers.

14.3 MEANING OF CONTROLLING

Managerial planning results in the framing of objectives and laying down of targets. To achieve the objectives, a proper organisational structure is designed; people are assigned the various tasks; and are directed to perform their respective jobs. The actual performance is then assessed from time to time to ensure that what is achieved is in conformity with the plans and targets. This exactly is the controlling function. Thus, controlling as a function of management refers to the evaluation of actual performance of work against planned or standard performance and taking the corrective action, if necessary.

According to Henri Fayol, "Control consists in verifying whether everything occurs in conformity with the plan adopted, the instructions issued and principles established."

According to Brech, "Control is checking current performance against predetermined standards contained in the plans, with a view to ensure adequate progress and satisfactory performance, and also recording the experience gained from the working of these plans as guide to possible future needs.

Planning and controlling are closely related and depend upon each other. Controlling depends upon planning because planning provides the targets or standards against which actual performance can be compared. Controlling, on the other hand, appraises planning. It brings out the shortcomings of planning and helps to improve upon the plans. For example, in a factory, 10 workers are required to cut steel sheets into small round pieces. The work plan prescribes that each worker should cut 40 pieces in a day (240 pieces per week). After a week, the manager finds that, out of 10 workers, 6 were able to cut only 200 pieces each and 4 could cut only 180 pieces each. In order to find out the causes of this deviation he evaluates the physical facilities provided to workers in the work place.

On being satisfied with these conditions, the manager concludes that the target of 240 pieces per week is too high for workers to achieve. Therefore, it should be revised from 240 to 200 pieces per week. Thus, the manager revises the plan because the control exercise indicated that standard he had fixed was unreasonably high and beyond the reach of the workers. It may be noted that in order to exercise effective control, managers should not only have the standards but also see that information on the gaps between actual and standard performance is made available and action taken to rectify the deviations, if any. This is essential because, without such information, managers will not be able to measure the deviations and, without corrective action, the entire control process would be a meaningless exercise.

You should also make a note that controlling does not simply involve checking the quantity of work done but also includes checking the quality of performance, the time taken and the cost incurred. In the above example, suppose each worker could cut 240 pieces per week but most of the pieces were not of the specified size or there was an excessive wastage of steel sheets. This would result in unnecessary loss to the organisation. Hence, the managers have to take steps so that the quality of work is improved and the wastage is reduced.

Thus, controlling involves

(i) knowing the nature, quantum and time frame of the work;

(ii) comparing the performance with the plan;

(iii) analysing deviation, if any;

(iv) taking corrective steps; and

(v) suggesting revision of plans, if necessary.

14.4 CHARACTERISTICS OF CONTROL

The following are the basic characteristics of control.

1. **Planning is the Basis of Control :** Control is said to be checking performance as per what has been planned. So planning precedes controlling and sets the standards and targets of performance.

2. **Control is a Continuous Process :** It is an ongoing and dynamic function of management. It involves a continuous review of performance and is not a one-time exercise. The period of control normally depends upon the nature of work, the amount of work and the policies of management.

3. **Control is All Pervasive :** Control is exercised at all levels of management, and is done in every functional area and at each unit or department. Thus, control is all pervasive.

4. **Action is the Essence of Control :** Control is an action-oriented process. The very purpose of control is defeated if corrective action is not taken for improvement of performance or the revision of plans.

5. **Control is Forward Looking :** Control is futuristic in nature. It measures current performance and provides guidelines for the corrective action. This ensures future performance as per plans. Thus, it is forward looking.

14.5 WHY CONTROL IS NEEDED

Controlling is one of the important functions of management. It pinpoints the deviations on the basis of which managers can take corrective steps. If no control is exercised, work may not be done as desired and inefficiencies may remain undetected. For example, suppose there is a workshop in which bookbinding is done. The owner hires five persons and tells them that at least four books should be bound per hour. The workers work for six hours a day. At the end of the day, he calls each of them to assess the work done. He finds that 'A' could bind 28 books, 'B' 25 books, 'C' 24 books, and 'D' and 'E' could bind 22 and 20 books respectively. He appreciates A's work and compliments him. He warns 'D' and 'E' because they failed to achieve the standard. His action to compliment 'A' and warn 'D' and 'E' is primarily due to his controlling process. Suppose he does not check the work and treats all the workers alike, 'A' may not be inclined to show better performance and the inefficiency of 'D' and 'E' will not be detected and is likely to continue.

The importance of control has considerably increased now-a-days due to several reasons. Business units have grown in size and include a large variety of operations. There is greater competition in the market among different producers and sellers. Hence, the managers have to maintain and continuously improve the efficiency of operations. For this purpose, regular checking of the work done is required. This may also help in minimising the cost and wastage. It is also necessary that targets of achievement are raised from time to time and employees duly rewarded for better performance of work. This is possible only through the process of control. Thus, controlling

(a) helps in achieving the targets;

(b) helps in taking corrective action on time;

(c) helps in monitoring and improving employees performance;

(d) helps in achieving better coordination;

(e) helps in better planning;

(f) helps in minimising errors;

(g) facilitates decision making; and

(h) simplifies supervision.

Relationship between Planning and Controlling

Planning fixes the goals/standards to be achieved. Controlling checks the actual performance with the standards fixed. Therefore, planning fixes the criteria for controlling. Thus, without planning control is blind.

Planning sets the course of actions. Control compares the actual course and the planned course. Control identifies deviations from the course and initiates corrective actions. Planning is fruitful when control is exercised.

Planning is forward looking as all plans are prepared for future. But it looks ahead on the basis of past data. So we can say planning is both backward looking and forward looking.

Controlling is forward looking because controlling involves comparing the actual performance with the planned performance. Controlling is backward looking because manager looks back at previous year's performance to find the deviations from the standard. Like planning, controlling is also both backward looking and forward looking.

INTEXT QUESTIONS 14.2

1. State the meaning of the term 'controlling' in your own words.

2. Complete the following incomplete words with appropriate letters by using clues given at the bottom. Each blank represents one letter only.

   (a) D __ V __ __ T __ ON　　(b) P __ __ V A __ __ V __

   (c) F __ T __ __ I __ T I __　　(d) __ N __ __ I N __

   Clues

   (a) When actual performance is different from planned performance.

(b) Control is needed at all levels, in every functional area.

(c) Control is forward looking.

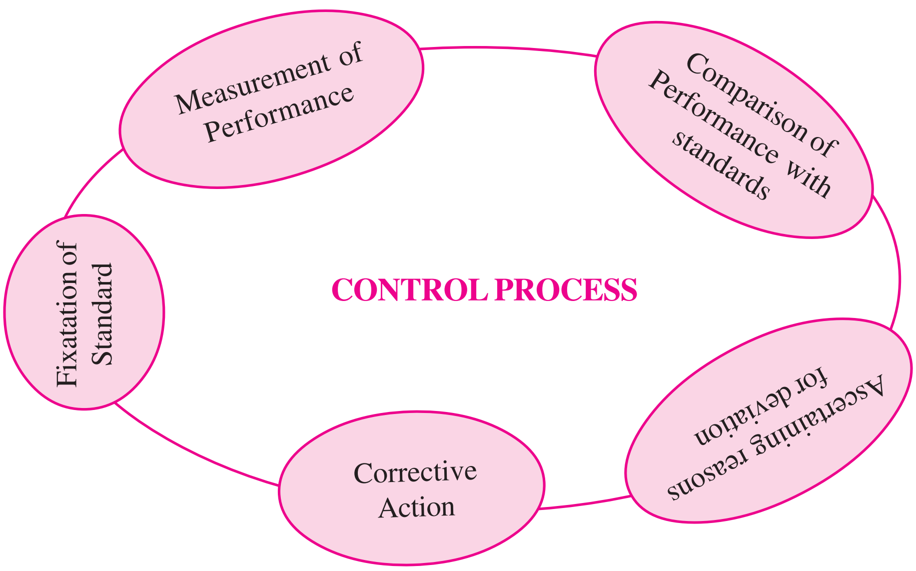
(d) Control is a continuous process.

Notes

14.6 PROCESS OF CONTROL

The process of control consists of various steps. Look at the following example.

Ram is employed in a garments manufacturing company. His job is that of sewing trousers. His supervisor specifies that he should sew 20 trousers in a day. This is the first step of the control process, i.e., fixation of standards. At the end of the day, the supervisor counts and finds that Ram has completed only 18 trousers. Thus, the "measurement of performance" is the second step in the control process. Then he compares it with the standards. This is the third step of the control process called "comparison of performance with standards". While comparing the performance of the other workers he finds that the two workers have produced less than the standard. When the supervisor tries to ascertain the reasons for the poor performance, he finds that machines on which the other two workers were working had developed some fault. This is the fourth step in controlling and is known as "ascertaining reasons for deviation". Then, in order to avoid such unexpected defects in machinery in future, the supervisor decides that everyday there will be an inspection of all tools and equipments. This is "corrective action", which is the fifth and last step in controlling.



Let us now discuss these steps in detail.

1. **Establishment of Standards :** Setting standard is the first requirement of control. Standards arise out of plans and provide the basis of comparison. There can be different types of standards, e.g., number of units to be produced per hour, cost of production per unit, permissible quantity of scrap and wastage per day, quality of the products and so on. As far as possible, the standards should be laid down in quantitative terms. A quantitative standard provides a concrete measure and helps in comparison. It is equally important that the standards fixed are realistic and attainable, neither too high nor very low. If these are too high, employees will be discouraged. On the other hand, if these are too low, the organisation will operate at a lower efficiency level leading to higher cost.

   When standards may not be achieved fully, a range of tolerable deviations should also be fixed. This can be expressed in terms of minimum and maximum limits. Performance within the permissible range may not require any corrective action.

2. **Measurement of Performance :** When standards are established, the next step is to measure the performance at regular intervals. Measurement is not difficult in case of physical operations, e.g., units produced, cost incurred, time spent, etc., as these can be easily measured. Performance can be measured by observations, inspection and reporting. Generally, at lower levels, a detailed control is exercised at frequent intervals on the basis of observation and inspection. For higher levels of management, reports are prepared at regular intervals. Performance should be measured as early as possible so that if a corrective action is called for it may be taken in time.

3. **Comparison of Performance with Standards :** The next step in the control process is comparison of actual performance against the standards. In case the standards set are well defined and can be measured objectively, comparison becomes very simple. But, in case of activities where, it is difficult to develop measurable quantitative standards, the measurement and appraisal of performance becomes difficult.

   Comparison of actual and standard performance may lead to three possible outcomes: actual performance may be (a) equal to, (b) more than, or (c) less than the standard. If actual performance is equal to the standard, managers need not take any action but where deviations are noticed, corrective action becomes necessary. The managers should ascertain whether these deviations are within the permissible range or outside it. Corrective action becomes necessary only for deviations which fall outside the permissible range.

4. **Detecting the Reasons for Deviations :** Before taking any corrective action, managers should try to ascertain the reasons for the occurrence of deviations. The fault may be that standards fixed were unattainable rather than the subordinate's

inefficiency. Again, the deviations might have been caused by the nature of instructions issued by the manager rather than due to the subordinate's mistake. Hence, it is essential that the reasons, which caused the deviation, be ascertained to determine the appropriate corrective action.

5. **Taking Corrective Action :** Once the causes for deviations become known, the next step is to go in for a corrective action which may involve revision of standards, changing the methods of selection and training of workers or providing better motivation. As stated earlier, managers should concentrate only on major deviations. The minor deviations, i.e., deviations within permissible range, should not be a cause of anxiety. The rectification of deviations from the standards should be undertaken promptly so that further losses are avoided.

INTEXT QUESTIONS 14.3

1. Match the phrases in column (I) with those in column (II)

	Column (I)	Column (II)
(a)	Fixation of standards	(i) Actual work done
(b)	Measurement of performance	(ii) Comparison of actual performance with the standards.
(c)	Appraisal of performance	(iii) Establishing the desired level of performance.
(d)	Determination of reasons for deviation	(iv) Efforts to make the actual performance confirm to the standards.
(e)	Taking corrective action	(v) Why is there a difference between actual performance and standard performance.

2. Following is the sequence of events in Gopal's readymade dress factory during the month of April 2014. Arrange them in proper order keeping in mind the process of control.

   (a) Gopal fixed a target of 500 shirts for the month of April 2014.

   (b) Gopal changed defective machines and also the incompetent workers.

   (c) On 30 April 2014 Gopal found only 400 shirts could be prepared.

   (d) Gopal was upset to see the output as it was 100 shirts less than the target set for the month.

   (e) Gopal found some machines were giving trouble and also some incompetent workers wasting their own and other's time.

WHAT YOU HAVE LEARNT

- Co-ordination means orderly arrangement of group efforts to provide unity of action in the pursuit of a common goal.
- The significance of co-ordination as a function of management arises mainly from the fact that without harmonized efforts, different activities may result in neglect of the organisational goals.
- Control refers to evaluation of actual performance and taking corrective action, if necessary.
- Controlling is important to make planning a success. For this purpose, it is necessary to compare actual performance with the planned performance. The difference between actual and planned performance is called 'deviation'. Control means determining the deviation, identifying the reasons for deviation and correcting the deviations.
- Characteristics of the controlling function of management:
  - closely associated with planning;
  - all pervasive;
  - action is the essence of control;
  - continuous process; and
  - exercised at all levels of management.
- Steps in the process of control
  - establishment of standards;
  - measurement of performance;
  - comparison of actual performance with planned performance;
  - determination of reasons for deviation;
  - taking corrective action.

KEY TERMS

Control	Measurement of performance	Unity of action
Co-ordination	Standards	Working at cross purposes
Deviations	Supervision	

TERMINAL EXERCISE

Very Short Answer Type Questions

1. State any two advantages of coordination.
2. State any four characteristics of control.
3. What is 'deviation' in the context of control?
4. State any two reasons of importance of control.
5. What do you mean by controlling.

Short Answer Type Questions

6. What is meant by control?
7. List the steps in the process of control.
8. Explain briefly why coordination is called essence of management?
9. Planning and control are inseparable. Discuss in brief.
10. What should a manager do when there is difference between actual and standard performance.
11. 'There is a close and reciprocal relationship between planning and controlling'. Comment.

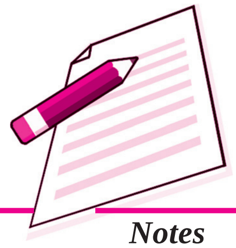
Long Answer Type Questions

12. Explain various steps of the process of control.
13. Co-ordination is needed at all levels and in all functional areas of management. Comment.
14. Describe the characteristics of control.
15. State the meaning of controlling. Why is it required that every organisation must follow certain control system in its activities.
16. Describe in detail the relation between controlling and planning.

ANSWERS TO INTEXT QUESTIONS

14.1 2. (a) Coordination leads to unity in action.

(b) The importance of co-ordination is lesser in small organisations.



Notes

(c) Correct

(d) Coordination is the function of all levels of management.

(e) Correct

14.2 (a) DEVIATION (b) PERVASIVE

(c) FUTURISTIC (d) ONGOING

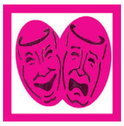
14.3 1. (a) – (iii) (b) – (i) (c) – (ii)

(d) – (v) (e) – (iv)

2. 1 (a) 2 (c) 3 (d) 4 (e) 5 (b)

DO AND LEARN

Mohan is the owner of a tailoring shop supplying school uniforms. He has 3 workers. He himself does the cutting work. For a long time he is receiving complaints from his customers that the dresses are not delivered to them in time. What should he do so that customers may be served in time? Get in touch with a tailor or persons involved in such activities to ascertain the reasons and suggest a suitable measure.



ROLE PLAY

Ram Swaroop is a businessman having a ball-bearings making factory. About six months ago, he had set up a small unit for his son Suyash. There he makes inverter batteries. While having breakfast on a Sunday morning he asked his son about the progress in his business. His son was looking tense and unhappy.

Ram Swaroop : What is the matter? Are you doing fine in your business?

Suyash : No papa, things do not seem to be working out. Profits are not as good as I wanted.

Ram Swaroop : If we are not able to achieve the targets in terms of sale, profit, cost, resource utilisation etc, either our targets are too high or our performance is below standards. We need to evaluate both from time to time.

Suyash : Papa, once I have invested money, bought the latest machines, raw materials and employed competent people, why should I not get the desired profits?

Ram Swaroop : Business is not simply making and implementing the plans. Another important part is taking the performance in the right direction with proper use of control.

Suyash : Control?

Ram Swaroop : Controlling is ensuring from time to time that performance is according to the targets set.

(Further Ram Swaroop guided his son as to how he can ensure that his unit makes profits like others, using proper process of control)

Choose a role for yourself and one for your friend and continue the conservation.

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15

FINANCING OF BUSINESS

You must have seen a doctor busy in running his clinic, a shopkeeper selling groceries, or a tailor busy in stitching clothes. They all are pursuing their occupations or doing business to earn their livelihood. To become successful in their occupation or business all of them need some amount of funds (money) to buy the required materials, tools and equipments. The doctor has to purchase medical equipments and furniture to run his clinic, the shopkeeper has to buy groceries, the tailor has to purchase sewing machine, threads and other stitching materials for his work. Thus, any type of business or occupation requires money at every stages of its operation. Now, the question arises from where do the businessmen gather the required amount of money? Are they able to manage with their own money to start and run their business? Obviously, it is difficult and in case of large business, it is ruled out. So we have to know what are the various options available to them to arrange the required amount of funds (also called capital). In this lesson, we shall try to find out the answer to such questions.

OBJECTIVES

After studying this lesson, you will be able to:

- state the meaning of business finance;
- explain the need and importance of business finance;
- identify the different types of business finance;
- explain the various methods of raising short-term finance;
- suggest various types of securities required to obtain bank credit and
- describe the various methods of raising long term finance.

15.1 BUSINESS FINANCE

We all know that every business requires some amount of money to start and run the business. Whether it is a small business or large, manufacturing or trading or transportation business, money is an essential requirement for every activity. Money required for any activity is known as finance. So the term 'business finance' refers to the money required for business purposes and the ways by which it is raised. Thus, it involves procurement and utilisation of funds so that business firms will be able to carry out their operations effectively and efficiently.

You know that a business unit cannot move a single step without sufficient amount of finance. But before discussing the importance of finance, let us learn in detail as to why does the business need funds.

Every business needs funds mainly for the following purposes:

1. **To purchase fixed assets :** Every type of business needs some fixed assets like land and building, furniture, machinery etc. A large amount of money is required for purchase of these assets.

2. **To meet day-to-day expenses :** After establishment of a business, funds are needed to carry out day-to-day operations e.g., purchase of raw materials, payment of rent and taxes, telephone and electricity bills, wages and salaries, etc.

3. **To fund business growth :** Growth of business may include expansion of existing line of business as well as adding new lines. To finance such growth, one needs more funds.

4. **To bridge the time gap between production and sales :** The amount spent on production is realised only when sales are made. Normally, there is a time gap between production and sales and also between sales and realisation of cash. Hence, during this interval, expenses continue to be incurred, for which funds are required.

5. **To meet contingencies :** Funds are always required to meet the ups and downs of business and for some unforeseen problems. Suppose, a manufacturer anticipates shortage of raw materials after a period, then he would like to stock the raw materials in large quantity. But he will be able to do so only if sufficient money is available with him.

6. **To avail of business opportunities :** Funds are also required to avail of business opportunities. Suppose a company wants to submit a tender for which some amount of money is required to be deposited along with the application. In case of non-availability of funds it would not be possible for the company to submit the tender. Take another example. When a stockist offers special discount on large amount of purchase of any particular material then a manufacturer can avail of such offer, only if he has adequate funds to buy it.

Notes

15.2 IMPORTANCE OF BUSINESS FINANCE

Finance is the most important requirement of every business and it is considered as life-line of the business. Inadequate finance poses many problems and may bring an end to the life of the business. The importance of finance has considerably increased in modern days due to following reasons in addition to the usual need:

(a) **Need for Large Scale Operation :** Now-a-days business activities are generally undertaken on a large scale. The products of any country are now freely and easily available in other countries. The entire world has become a big market. So to survive in the business world the businessman has to expand the horizon of his activities and function on large scale. This expansion of business always demands more funds.

(b) **Use of Modern Technology :** Use of latest technology in the process of production as well as distribution has become imperative for every business now-a-days. To meet the competition, production process now demands use of modern machinery, equipments and tools. Hence, there is a greater need for finance to meet the challenge of the world's markets successfully.

(c) **Promotion of sales :** In this era of competition lot of money is to be spent on activities for promoting sales. This involves advertisement, personal selling, use of sales promotional schemes, providing after sales service and free home delivery, etc. which need huge amount of funds.

15.3 TYPES OF BUSINESS FINANCE

You have learnt that in every business activity money is an important as well as essential component. Now let us see the nature and types of financial requirement of the business enterprises.

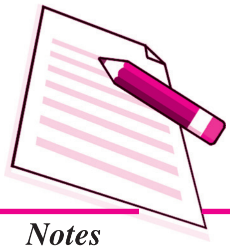
The type and amount of funds required usually differs from one business to another. For instance, if the size of business is large, the amount of funds required will also be large. Likewise, the financial requirements are more in manufacturing business as compared to trading business. The business needs funds for longer period to be invested in fixed assets like land and building, machinery etc. Sometimes, the business also needs funds to be invested for shorter period. So based on the period for which the funds are required, the business finance is classified into three categories.

(a) Short-term Finance;

(b) Medium-term Finance; and

(c) Long-term Finance;

Let us now learn about each of them in detail.



Notes

Short-term Finance

Funds required to meet day-to-day expenses are known as short-term finance. This is required for purchase of raw materials, payment of wages, rent, insurance, electricity and water bills, etc. The short-term finance is required for a period of one year or less. This financial requirement for short period is also known as working capital requirement or circulating capital requirement. It may be noted that a part of the working capital requirement is of a long-term nature, as certain minimum amount of funds are always kept to meet the requirement of stock and regular day-to-day expenses.

Medium-term Finance

Medium-term finance is utilised for all such purposes where investments are required for more than one year but less than five years. Amount required to fund modernisation and renovation, special promotional programmes etc. fall in this category.

Long-term Finance

The amount of funds required by a business for more than five years is called long-term finance. Generally this type of finance is required for the purchase of fixed assets like land and building, plant and machinery, furniture etc. The long-term finance is also known as fixed capital as such need in fact is, of a permanent nature.

Types of Finance	*Period of Repayment*	*Purpose*
Short-term	Less than a year	Purchase of raw materials, payment of wages, rent, insurance etc.
Medium-term	One year to five years	Expenditure on modernisation, renovation, heavy advertising etc.
Long-term	More than five years	Purchase of land and building, plant and machineries, etc.

Every organisation need different types of finance i.e., long-term, medium-term as well as short-term. But the combination in which these are used differ from one business to another. For example, steel industry requires more long-term finance to be invested in land and building and machinery as compared to the manufacturing of leather goods or plastic buckets. Similarly, for manufacturing hosiery items, requirement of short-term finance would be more than that of long-term finance.

Concepts of fixed and working capitals

You are aware that the capital of a business is invested in different types of assets like land and building, furniture, machines, raw material, stock of finished goods etc. Some of these assets are used over a long period of time and hence are generally of a permanent nature. Fixed capital refers to the total value of assets in a business, which are of durable nature and used in a business over a considerable period of time. It comprises assets like land, building, machinery, furniture etc. The capital invested in these assets is fixed in the sense that these are required for permanent use in business and not for sale.

Working capital consists of those assets which are either in the form of cash or can easily be converted into cash, e.g., cash and bank balances, debtors, bills receivable, stock, etc. These assets are also known as current assets. Working capital is needed for day-to-day operations of the business. However, a part of working capital is required at all times to maintain minimum level of stock and cash to pay wages and salaries etc. This part of working capital is called 'permanent' working capital.

INTEXT QUESTIONS 15.1

1. List the various needs of the business for which funds are required.

2. Give examples of specific expenditures for which funds will be required for the following terms/time periods.

   (a) Short-term

   (b) Medium-term

   (c) Long-term

15.4 SOURCES OF FINANCE

Having learnt about the need, importance and types of financial requirements, now we must know from where the businessmen get the required amount of funds to meet the short-term, medium term and long term requirements. Who provides them the required amount? Let us learn about the various sources from which the businessmen generally arrange money for business purposes.

Broadly speaking, there are two main categories of sources from which the businessmen can get the required funds for their business. These are : (1) internal sources; and (2) external sources. You know that to start a business the businessman either invests his own money or borrows from outsiders or uses both the sources. When the businessman invests his own money (called owner's capital), and retains a part of the profits earned in the business it constitute the internal sources of finance. It is an integral part of every business organisation and it is cost effective. But, this source has its own limitations. Hence the business houses have to resort to the external sources of finance. The various external sources from where businessmen can get the finance include, friends and relatives, banks and other financial institutions, moneylenders, capital market, manufacturers and producers, customers, foreign financial institutions and agencies, etc.

It is observed that the scope of raising funds also depends upon the nature and form of business organisation. For example, a sole proprietorship form of business organisation has very limited sources from which it can arrange funds for the business. These are:

(a) Own Savings
(b) Friends and Relatives
(c) Moneylenders
(d) Commercial Banks
(e) Finance Companies
(f) Manufactures and Suppliers
(g) Retained Profits

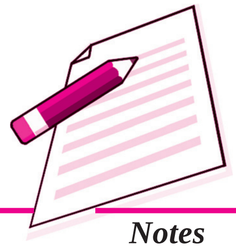
The same sources of financing are also available in case of partnership firms. In both sole proprietorship and partnership form of business organisation, long term capital is generally provided by the owners themselves by way of investing their own savings and retaining a part of the profits generated by the business and the rest of the above sources are mostly used for their short-term financial needs. However, in case of companies, the following are the usual sources of finance.

(a) Capital Market
(b) Financial Institutions
(c) Public Deposits
(d) Commercial Banks
(e) Leasing Companies
(f) Investment Trusts
(g) Retained Profits.

We shall learn in detail about these sources in the next chapter.

15.5 METHODS OF RAISING SHORT-TERM FINANCE

There are a number of methods used for raising short-term finance. These are :



Notes

1. **Trade Credit :** Trade credit refers to credit granted to manufacturers and traders by the suppliers of raw material, finished goods, components, etc. Usually business enterprises buy goods on 30 to 90 days credit. This means that the goods are delivered but payments are not made until the expiry of the period of credit. This type of credit does not make the funds available in cash but it facilitates purchases without making immediate payment which amounts to funding it by suppliers. This is a very popular source of short term finance.

2. **Bank Credit :** Commercial banks usually provide short-term finance to business firms, which is known as bank credit. When bank credit is granted, the borrower gets a right to draw the amount of credit as and when needed. Bank credit may be granted in any of the following ways:

   (a) **Loans and Advances :** When a certain amount of money is advanced by a bank repayable after a specified period, it is known as bank loan. Such advance is credited to a separate loan account and the borrower has to pay interest on the whole amount of loan irrespective of the amount of loan actually drawn. Usually loans are granted against security of assets.

   (b) **Cash Credit :** It is an arrangement whereby banks allow the borrower to withdraw money upto a specified limit. This limit is known as cash credit limit. This facility is granted against the security of goods in stock or promissory notes or other marketable securities like government bonds. Under this arrangement, the borrower can draw, repay and again draw the amount within the sanctioned limit. Interest is charged only on the amount actually withdrawn and not on the amount of entire limit.

   (c) **Bank Overdraft :** When a bank allows its depositors or account holders to withdraw money in excess of the balance in his current deposit account upto a specified limit, it is known as overdraft facility. This limit is granted purely on the basis of credit-worthiness of the borrower. Interest is charged only on the overdrawn money. Rate of interest in case of bank overdraft is less than the rate charged under cash credit.

   (d) **Discounting of Bill :** Banks also give advance money by discounting bill of exchange. When a bill of exchange is presented before the bank for encashment, bank credits the amount to customer's account after deducting some discount. The amount of discount is charged on the basis of the interest for the period of bill. On maturity of the bill, the payment is received by the bank from the drawee.

Distinction between Cash Credit and Bank Overdraft

(i) Cash credit is an arrangement of credit granted by a bank to a firm. The firm may or may not have an account with the bank. Overdraft is granted to an accountholder purely on the basis of his credit-worthiness. Credit worthiness is decided by the financial soundness of past dealings of the customer with the bank.

(ii) In case of cash credit, the amount of credit is placed in a separate account of the borrower. Overdraft limit is generally granted to an existing account of the customer.

(iii) The amount of credit in case of cash credit depends upon the value of securities offered. But overdraft limit is decided on the average balance in the customers account.

(iv) Overdraft is granted without the security of any assets. But for cash credit, security of tangible assets is an essential requirement.

3. **Factoring :** Factoring is a method of raising short-term finance for the business in which the business can take advance money from the bank against the amount to be realised from the debtors. By this method, the firm shifts the responsibility of collecting the outstanding amount from the debtors on payment of a specified charge. Here the business gets the money in advance without waiting for due date. Also it saves the effort of collecting the debts.

4. **Customers' Advances :** Sometimes businessmen insist their customers make some advance payment. It is generally asked when the value of order is quite large or goods ordered are very costly. Customers' advance represents a part of the payment towards sale price of the product(s), which will be delivered at a later date. Customers generally agree to make advance payment when such goods are not easily available in the market or there is an urgent need of any goods. A firm can meet its short-term requirements with the help of customers' advances.

5. **Installment Credit :** In business, credit that is granted on condition of its repayment at regular intervals, or installments, over a specified period of time. Installment credit is the means by which most durable goods such as automobilies and large home appliances are bought by individuals. The purchaser usually is advanced the goods after making an initial fractional payment called a down payment. If the purchaser defaults on his payments at some point, all previous payments are forfeited to the seller, who may also taken possession of the goods.

6. **Loans from Unorganised Sectors :** In addition to the above methods of raising funds, the businessmen always have the option to take the money from the unorganised sector like loans from the moneylender (called indigenous bankers), friends and relatives. To meet the short-term and urgent need of business, money can be obtained from them either on personal security or on security of tangible assets and personal properties. Since the interest charged on loans from unorganised sector is normally very high, the businessmen are not very keen to avail of loan from this source.

7. **Inter Corporate Deposits (ICDs) :** Deposits made by one company with another company for a short term are termed as Inter Corporate Deposits. It is a type of unsecured debt. It is arranged by a broker. This is a form of short term finance. This source of finance is free from legal formalities. ICDs are kept secret and are not disclosed to the public. The interest payable depends on the amount and period of deposit. There is no organised market for exchanging these deposits.

Types of ICDs

Following are the different types of inter corporate deposits:

(a) **Call Deposits :** Call deposits can be withdrawn by the lender by giving a one day notice. The rate of interest on such deposits is 10 % p.a.

(b) **Three Months Deposits :** These ICDs are for a period of three months. The rate of interest on these deposits is 12% p.a.

(c) **Six Months Deposits :** These ICDs are for a period of 6 months. The rate of interest on these deposits is 15% p.a.

15.6 TYPES OF SECURITY REQUIRED FOR OBTAINING BANK CREDIT

You have learnt that loans and advances are granted by the banks on the basis of some security, which will ensure the bank for safe return of its money. This security may be personal security of the borrower as well as on the security of some assets, besides the standing of the firm. Thus, securities offered against bank credit may be of two types:

(1) Personal security (2) Security of assets

Personal security means the credit-worthiness of the borrower. Banks judge the credit-worthiness of the borrower on the basis of his financial soundness and past dealings with the bank, and then sanction the amount. When the banks ask for security of assets, the following are generally accepted as security for extending short-term finance.

(a) **Moveable Goods :** Stock of raw materials and finished goods are accepted by banks as security against bank credit. In case of non-payment, these goods are sold and money is recovered by banks.

Notes

(b) Shares : Shares that are quoted on a recognised stock exchange are accepted as security against bank credit. The borrower is required to assign his share holding in favour of the bank.

(c) Documents of Title to Goods : Bill of Lading, Railway Receipts (RR), Goods Receipt (GR), Warehouse warrant are various documents which are recognised as documents of title to goods. To secure credit from bank, the borrower may deposit any of these documents with bank after duly endorsing the same in favour of the bank. This enables the bank to deal with the goods in case of default in repayment.

(d) Fixed Deposit Receipts : It is a receipt issued by bank as evidence of fixed deposit made by the customer. Banks grant loan on the security of this receipt. Banks normally grant loan upto 90% of the value of such receipts.

(e) Life Insurance Policies : Banks extend credit on the basis of life insurance policy upto the amount of surrender value of such receipts.

(f) Jewellery or Precious Metals : This type of security may be offered to borrow money for private as well as for business purposes. Sole proprietary concerns sometimes offer jewellery or other precious metals to obtain credit.

(g) Other Securities : Besides the assets and documents mentioned above, banks also accept National Savings Certificate (NSC), Kisan Vikas Patra (KVP), Government Bonds for grant of short-term credit.

INTEXT QUESTIONS 15.2

I. Give specific examples of the following kinds of assets that may be given as security for obtaining bank credit:

(a) Document of title to goods

(b) Moveable goods

(c) Jewellery or precious metals

II. Which type of bank credit is being referred to here:

(a) Accountholder is allowed to withdraw an amount in excess of the balance in his current account in the bank.

(b) The bank advances money against a document, after deducting some discount.

(c) Interest is charged on the amount actually withdrawn, and not on the entire amount sanctioned.

(d) The amount is credited to a separate account by the bank and interest is paid by the borrower on the whole of this amount, irrespective of the amount actually drawn.

III. Multiple choice Questions.

(i) Name the deposit arranged by one company with another company for a short term.

(a) Fixed deposit (b) Inter corporate deposits

(c) Owned deposit (d) Borrowed deposits

After knowing the various methods of raising short-term finance let us now learn about the methods of raising long-term finance.

15.7 SMALL BUSINESS

Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 has classified enterprises as follows :

1. Manufacturing Enterprises
   a) Micro Enterprise : A unit with an investment up to Rs. 25 lakh.
   b) Small Enterprise : A unit with an investment above Rs. 25 lakh and upto Rs. 5 crore.
   c) Medium Enterprise : A unit with an investment above Rs. 5 crore and upto Rs. 10 crore.
2. Service Enterprises
   a) Micro Enterprise : A unit with an investment up to Rs. 10 lakh.
   b) Small Enterprise : A unit with an investment above Rs. 10 lakh and up to Rs. 2 crore.
   c) Medium enterprise : A unit with an investment above Rs. 2 crore and up to Rs. 5 crore.

15.7.1 Role of Small Business in India

Small Scale Industries are small in size but constitute 95% of the industrial units in India. They contribute 45% of the total exports from India. They are helpful in the following ways :

1. **Employment :** As Small Scale Industries are laboure-intensive, they provide employment to a large number of people.

Notes

2. **Supply Variety of Products :** SSIs supply variety of products like mass consumption goods, readymade garments, stationery items, detergents, leather, plastic and rubber products, processed foods and vegetables, wood and steel furniture, safety matches etc. Some sophisticated items like electric and electronic goods such as TV, Calculator, agricultural tools etc. and handloom and handicraft products are made by SSIs.

3. **Balance Regional Development :** SSIs use single technologies and depend on locally available resources (material, labour etc.). This enables it to start its unit anywhere in the country.

4. **Opportunity for Entrepreneurship :** SSIs provide opportunity for entrepreneurship. These units can be started with little capital so talented and skilled people can have their own business units.

5. **Low Cost of Production :** SSIs use locally available resources which are less expensive. Therefore, establishment and running cost of small industries are less.

6. **Capture New Business Opportunities :** Due to the small size of the organisations, quick decisions can be taken by SSI units. This enables them to capture new business opportunities.

7. **Customised Production :** SSI units manufacture products according to the needs of customers. They manufacture products according to the specifications provided by consumers.

15.7.2 Role of Small Business in Rural India

Earlier rural people used to engage only in agriculture. With the formation of SSI Units many rural people started setting up agro-based rural industries.

Traditional artisans and persons engaged in cottage and rural industries get a good employment opportunity because of SSI unit. This prevented migration of rural population to urban areas in search of jobs.

In SSI units, labour intensive techniques are used. Therefore, it helped to remove the problem of poverty and unemployment. At the same time, SSIs help to utilise the rural potential to the maximum, thus, helping the country in a balanced regional development.

15.8 METHODS OF RAISING LONG TERM FINANCE

You have already learnt about the purpose for which long-term finance is required by the business. In small organisations the long-term finances are generally provided by the owners. But for large organisations like joint stock companies there are various options available to raise the long term finance. Followings are the most commonly used methods of long-term finance.

(i) Issue of Shares

(ii) Issue of Debentures

(iii) Loans from financial institutions

(iv) Public Deposits

(v) Retention of Profit

(vi) Lease financing

(vii) Foreign Investment

Let us now discuss about these in detail.

15.8.1 Issue of Shares

Share is the smallest unit into which the total capital of the company is divided. For example, when a company decides to raise Rs. 50 crores of capital from the public by issuing shares, then it can divide its capital into units of a definite value, say Rs. 10/- or Rs. 100/- each. these individual units are called as its share. After deciding the value of each share and number of shares to be issued, the company then invites the public to buy the shares. The investing public then buy the shares as per their capabilities. The investors who have purchased the shares or invested money in the shares are called the shareholders. They get dividend as return on their investment.

You know that investors are of different habits and temperaments. Some want to take lesser risk and are interested in a regular income. While others are ready to take greater risk in anticipation of huge profits in future. In order to tap the savings of different types of people, a company can issue two types of shares, viz. (a) Equity Shares, and (b) Preference shares.

(a) Equity Shares

Equity shares are shares, which do not enjoy any preferential right in the matter of claim of dividend or repayment of capital. The equity shareholders get dividend only after making the payment of dividends on preference shares. There is no fixed rate of dividend for equity shareholders. The rate of dividend depends upon the surplus profits. In case there are good profits, the company pays dividend to the equity shareholders at a higher rate. Again in case of winding up of a company, the equity share capital is refunded only after refunding the claims of others. In fact they are regarded as the owners of the company who exercise their authority through the voting rights they enjoy. The money raised by issuing such shares is known as equity share capital. It is also called as ownership capital or owners' fund.

Merits of Equity Shares

From Shareholders point of view

- The equity shareholders are the owners of the company.
- It is suitable for those who want to take risk for higher return.
- The value of equity shares goes up in the stock market with the increase in profits of the concern.
- Equity shares can be easily sold in the stock market.
- The liability is limited to the nominal value of shares.
- Equity shareholders have a say in the management of a company as they are conferred with voting rights.

From Management point of view

- A company can raise capital by issuing equity shares without creating any charge on its fixed assets.
- The capital raised by issuing equity shares is not required to be paid back during the lifetime of the company. It will be paid back only when the company is winding up.
- There is no binding on the company to pay dividend on equity shares. The company may declare dividend only if there are enough profits.
- If a company raises more capital by issuing equity shares, it leads to greater confidence among the creditors.

Limitations of Equity Shares

From Shareholders point of view

- Equity shareholders get dividend only when the company earns sufficient profits. The decision to declare dividend lies with the Board of Directors of the company.
- There is high speculation in equity shares. This is particularly so in the time of boom when profitability of the companies is high.
- Equity shareholders bear a very high degree of risk. In case of losses they do not get dividend, and in case of winding up of a company, they are the last to get the refund of their money invested. Equity shares actually swim and sink with the fate of the company.

From Management point of view

- It requires more formalities and procedural delay to raise funds by issuing equity shares. Also the cost of raising capital through equity share is more as compared to debt.

- As the equity shareholders carry voting rights, groups are formed to garner the votes and grab the control of the company. This may lead to conflict of interests, which is harmful for the smooth functioning of a company.

(b) Preference Shares

Preference Shares are those shares, which carry preferential rights in respect of dividend and return of capital. Before any dividend is paid to the equity shares, the dividend at a fixed rate must be paid on the preference shares. However, this dividend is payable only if there are profits. Again at the time of winding up, the holder of the preference shares will get the return of their capital before anything is paid to the equity shareholders. The holders of the preference shares do not have any voting right. So, they cannot take part in the management of the company. It is not compulsory on the part of the company to issue preference shares.

Types of Preference Share

A company has the option to issue different types of preference share. Let us see what are the different types of preference share a company can issue.

(i) **Convertible and Non-convertible Preference Share :** The preference shares which can be converted into equity shares after a specified period of time are known as convertible preference share. Otherwise, it is known as non-convertible preference share.

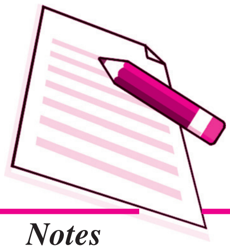
(ii) **Cumulative and Non-cumulative Preference Share :** In vumulative preference shares, the unpaid dividends are accumulated and carried forward for payment in future years. On the other hand, in non-cumulative preference share, the dividend is not accumulated if it is not paid out of the current year's profit.

(iii) **Participating and Non-participating Preference Share :** Participating preference shares have a right to share the profit after making payment of divided at a predecided rate to the equity shares. The non-participating preference shares do not enjoy such a right.

(iv) **Redeemable and Irredeemable Preference Share :** Preference shares having a fixed date of maturity are called as redeemable preference shares. Here, the company undertakes to return the amount to the preference shareholders immediately after the expiry of a fixed period. Where the amount of the preference shares is refunded only at the time of liquidation, are known an irredeemable preference shares.

Difference between equity shares and preference shares

We have already learnt the meaning and features of equity and preference shares. Now let us find out the differences between these two.


Notes

Basis of difference	*Equity shares*	*Preference Shares*
(i) Choice	It is compulsory to issue these shares.	It is not compulsory to issue these shares.
(ii) Payment of dividend	Dividend is paid on these shares only after paying dividend on preference shares.	Dividend is paid on these shares in preference to the equity shares.
(iii) Return of capital	In case of winding up of the company the equity share capital is refunded only after the refund of preference share capital.	In case of winding up of the company the capital is refunded in preference over the equity shares.
(iv) Voting Right	The equity shareholders enjoy voting rights.	The preference shareholders do not have voting rights.
(v) Accumulation of Dividend	The dividends on equity shares are not accumulated and therefore, cannot be carried forward.	The unpaid dividends are accumulated and are carried forward to the future years in case of cumulative preference shares.

It may be noted that the companies have to follow a prescribed procedure for issue of shares as per the Companies Act and the guidelines issued by Securities and Exchange Board of India (SEBI).

You learnt about equity shares and preference shares. Now let us learn about debentures.

15.8.2 Issue of Debentures

The companies can raise long term funds by issuing debentures that carry assured rate of return for investors in the form of a fixed rate of interest. It is known as debt capital or borrowed capital of the company. The debenture is a written acknowledgement of money borrowed. It specifies the terms and conditions, such as rate of interest, time of repayment, security offered, etc. These are offered to the public to subscribe in the same manner as is done in the case of shares.

The debentureholders are the creditors of the company and are entitled to get interest irrespective of profit earned by the company. They do not have any voting right. So they do not interfere in the day-to-day management of the business. Ordinarily, debentures are fully secured. In case the company fails to pay interest on debentures or repay the principal amount, the debentureholders can recover it from sale of its assets.

Notes

Merits of Debentures

(a) Debentures are secured loans. On winding up of the company, they are repayable before making any payment to the equity and preference shareholders.

(b) The debentureholders get assured return irrespective of profit.

(c) Issue of debentures enables the company to provide high return to equity shareholders when the earnings of the company are good. This is called Trading on Equity.

(d) Debentureholders have no right either to vote or take part in the management of the company. So by issuing debentures the company raises the additional capital without diluting the control over its management.

(e) Interest paid on debentures is treated as an expense and is charged to the profits of the company. The company thus, saves income tax.

Limitations of Debentures

(a) If the earnings of the company are uncertain and unpredictable, issue of debentures may pose serious problems due to fixed obligation to pay interest and repay the principal. So, when the company expects good and stable income, then only it should issue debentures.

(b) The company, which issues debentures, creates a charge on its assets in favour of debentureholders. So a company not having enough fixed assets cannot borrow money by issuing debentures.

(c) The assets of the company once mortgaged cannot be used for further borrowing. So, issue of debentures reduces the borrowing capacity of the company.

Trading on Equity

Trading on Equity refers to the use of high debt for ensuring higher returns for the equity shareholders. This is workable when the profitability is high and the rate of return on investment of funds is higher than the rate of interest to be paid on the borrowed money. Let us take an example. Suppose Rs. 5 crores is required to be invested on a project that may give 20% return per annum. If the management decides to raise Rs. 2.50 crores by issuing equity shares of Rs. 10 each and Rs. 2.5 crores by issuing 10% debentures, then the shareholders will get a return of 30% on their funds. Let us the see calculation.

Total earnings	Rs. 1,00,00,000
Interest on debenture @10%	Rs. 25,00,000
Earning after paying interest	Rs. 75,00,000

Notes

Return on Equity Share Capital $= \frac{75,00,000}{2,50,00,000} \times 100 = 30\%$

Now if the company decides to raise 80% by debt and only 20% by shares (Rs. 4 crores by 10% debentures and Rs. 1 crore by shares), the return on equity share capital will be calculated as follows:

Total earnings	Rs. 1,00,00,000
Interest on debenture @10%	Rs. 40,00,000
Earning after paying interest	Rs. 60,00,000

Return on Equity Share Capital $= \frac{60,00,000}{1,00,00,000} \times 100 = 60\%$

We can see that with the use of higher proportion of debt the rate of return on equity capital has simply doubled. At the same time, it is also associated with high risk that, if the profitability declines to less than 10%, we shall still have to pay 10% on debentures. This will reduce the return on equity share capital to less than even 10%.

Types of Debentures

Debentures may be classified as:

(i) Redeemable and Irredeemable Debentures : The debentures which are repayable on a specified date, are called redeemable debentures. On the other hand, there is no fixed time by which the company is bound to pay back the money in case of irredeemable debentures. These debentureholders cannot demand to get back their money as long as the company does not make any default in payment of interest. So these debentures are also called perpetual debentures.

(ii) Convertible and Non-convertible Debentures : The holders of convertible debentures are given the option to convert their debentures into equity shares. But incase of non-convertible debentures the company does not give any such option.

(iii) Secured and Unsecured Debentures : Secured debentures are issued with a charge on the assets of the company as security. This charge may be fixed i.e., on specified asset, or it may be floating. Secured debentures are also known as mortgaged debentures. On the other hand, unsecured debentures are issued with merely a promise of payment without having any charge on any assets as security. So these debentures are also known as naked or simple debentures. Now-a-days debentures are invariably issued as secured debentured.

(iv) **Registered and Bearer Debentures :** For registered debentures the issuing company maintains a record of the debentureholders. Any sale or transfer of such debentures must be registered with the company. On the other hand, bearer debentures are just like negotiable instruments and transferable by mere delivery. The company keeps no record of such debenture-holders. Interest coupons are attached to them and anybody can produce the coupon to get the interest.

After having some idea about shares and debentures let us find out the difference between them.

Difference between Shares and Debenture

Basis	*Shares*	*Debentures*
1. Status	Shareholders are the owners of the company. They provide ownership capital which is not refundable unless the company is liquidated.	Debentureholders are the creditors of the company. They provide loans generally for a fixed period, which are to be paid back.
2. Nature of return on investment	Shareholders get dividends. Its amount is not fixed as it depends on the profit of the company.	Interest is paid on debentures at a fixed rate. Interest is payable even if the company is running at a loss.
3. Rights	Shareholders are the real owners of the company. They have the right to vote and determine the policies of the company.	Debentureholders do not have the right to attend meetings of the company. So they have no say in the management of the company.
4. Security	No security is required to issue shares.	Generally debentures are secured. So, sufficient fixed assets are required when debentures are to be issued.
5. Order of repayment	Share capital is paid back only after paying the debentureholders and creditors.	Debentureholders have the priority of repayment over shareholders.
6. Risk	Risk is high due to uncertainty of returns.	Little risk due to certainty of return.

Notes

INTEXT QUESTIONS 15.3

I. Complete the following chart that compares equity shares and preference shares:

Basis of Difference	*Equity shares*	*Preference shares*
(1) Payment of dividend on shares	Dividend paid after paying dividend on preference shares	(a) ....
(2) Return of capital on winding up of company	(b)	Capital is refunded in preference over the equity shares.
(3) Voting rights	(c)	Do not carry voting rights
(4) Accumulation of Dividend	Dividend is not accumulated and therefore cannot be carried forward	(d) ....

II. Some of the features of the different methods of raising long-term capital are given below. Identify the features that relate to equity shares, preference shares and debentures.

(i) In case of winding up of the company, the capital is refunded after payment of debentures but before payment to equity shareholders.

(ii) Their holders are creditors of the company for a fixed period.

(iii) Their holders are the owners of the company and enjoy voting rights.

(iv) They bear high degree of risk-in case of losses they do not get dividend and in case of winding up of the company, they are the last to get refund of their invested money.

(v) Their holders have no say in the management of the company and they do not have the right to attend the company's meetings.

Notes

III. Mention the difference between shares and Debentures, on the basis of the criteria listed below:

Basis	***Shares***	***Debentures***
1. Status		
2. Rights		
3. Security		
4. Risk		

IV. Multiple Choice Questions :

i. Name the types of manufacturing industry in which Rs. 50 lakhs have been invested.

a) Micro Enterprise b) Small Enterprise

c) Tiny Units d) None of the above

ii. Identify the service industry which have investment of Rs. 20 lakh.

a) Micro Enterprise b) Small Enterprise

c) Tiny Units d) None of the above

iii. A service enterprise with an investment of Rs. 3 crore is called a :

a) Micro Enterprise b) Small Enterprise

c) Medium Enterprise d) None of the above

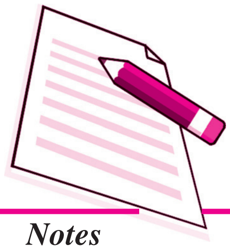
15.8.3 Loan from Special Financial Institutions (SFI)

After independence a large number of financial institutions have been established in India with the primary objective to provide medium and long-term financial assistance to industrial enterprises. Institutions like Industrial Finance Corporation of India (IFCIs), Industrial Reconstruction Bank of India, State Financial Corporation (SFCs), State Industrial Development Corporation (SIDCs), have been established to provide financial support to set up new enterprises as well expansion and modernisation of the existing enterprises.

These financial institutions grant loans for a maximum period of 25 years. These loans are covered by mortgage of companies property and/or hypothecation of stocks shares etc. The major benefit derived from such loans are :

(i) The rate of interest payable is lower than the market rate and

(ii) The amount of loan is large.



Notes

However, it involves a number of legal and technical formalities and also the negotiation period is usually long. The financial institutions often nominate one or two directors to have some degree of control over the utilisation of funds and the functioning of the company.

15.8.4 Borrowing From Commercial Banks

Traditionally, commercial banks in India were not granting long-term loans. They were granting loans only for a short period not extending beyond one year. But recently they have started giving loans for a period of 3 to 5 years. Normally they give term loans for one or two years. The period is extended at intervals and in some cases loan is given directly for 3 to 5 years. Commercial banks provide long-term finance to small-scale units in the priority sector.

Merits

The merits of long-term borrowing from banks are as follows:

1. It is a flexible source of finance as loan amount can be increased as per the business need and can be returned in advance when funds are not needed.
2. Banks keep the financial operations of their clients secret.
3. Time and cost involved are lower as compared to issue of shares, debentures etc.
4. Banks do not interfere in the internal affairs of the borrowing concern.
5. Loans can be paid back in easy installments.
6. In case of small-scale industries and industries in villages and backward areas, the interest charged is very low.

Limitations

Following are the limitations of long term borrowing from commercial banks:

1. Banks require personal guarantee or pledge of assets while granting loans. So the business cannot raise further loans on these assets. Thus, it reduces the borrowing capacity of the borrowers.
2. In case the short-term loans are extended again and again, there is always uncertainty about their continuity.
3. Too many formalities are to be fulfilled for getting term loans from banks. These formalities make the borrowings from banks time consuming and inconvenient.

15.8.5 Public Deposits

It is a very old method of finance practised in India. When commercial banks were not there, people used to deposit their savings with business concerns of good repute. Even today it is a very popular and convenient method of raising short and medium term finance. Under this method companies can raise funds by inviting their shareholders, employees and the general public to deposit their savings with the company. To attract the public, the company usually offers a higher rate of interest than the interest on bank deposit. The period for which companies accept public deposits ranges between six months to 36 months.

Procedure of raising funds through Public Deposits

When an organisation wants to raise funds through public deposits it gives an advertisement in the newspapers. The advertisement highlights the achievements and future prospects of the undertaking and invites the investors to deposit their savings with it. It declares the rate of interest, which may vary depending upon the period for which money is deposited. It also declares the time and mode of payment of interest and the repayment of deposits. Normally they appoint some local firms to act as brokers and help them in providing service to the depositors.

Keeping in view the malpractices of certain companies, such as non-payment of interest for years together and not refunding the money, the Government has framed certain rules and made certain amendments in the Companies Act for their security. The maximum rate of interest and brokerage payable are decided by the Reserve Bank of India. The amount of deposit should not exceed 25% of the paid up capital and general reserves. The company is also required to maintain a Register of Depositors containing all particulars as to public deposits.

Merits

Following are the merits of public deposits.

1. **Simple and easy :** The method of borrowing money through public deposit is very simple. It does not require many legal formalities. It has to be advertised in the newspapers and a receipt is to be issued.

2. **No charge on assets :** Public deposits are not secured. They do not have any charge on the fixed assets of the company.

3. **Economical :** Expenses incurred on borrowing through public deposits are much less than expenses of other methods like issue of shares and debentures.

4. **Flexibility :** Public deposits bring flexibility in the capital structure of the company. These can be raised when needed and refunded when not required.

Limitations

Following are the limitations of public deposits.

1. **Uncertainty :** A concern should be of high repute and have a high credit rating to attract public to deposit their savings. There may be sudden withdrawals of deposits, which may create financial problems. Depositors are regarded as fair weather friends.

2. **Insecurity :** Public deposits do not have any charge on the assets of the concern. It may not always be safe to deposit savings with companies particularly those, which are not very sound financially.

3. **Limits on the amount raised :** There are limits on the amount that can be raised through public deposits.

15.8.6 Retention of Profit

Like an individual, companies also set aside a part of their profits to meet future requirements of capital. The portion of the profits, which is not distributed among the shareholders but is retained and reinvested in business, is called retained earnings or ploughing back of profits. As per Indian Companies Act 1956, companies are required to transfer a part of their profits in reserves like General Reserve, Debenture Redemption Reserve and Dividend Equalisation Reserve etc. These reserves can be used to meet long-term financial requirements like purchase of fixed assets, renovation and modernisations etc. This method of financing long-term financial requirement is also called as Retention of Profit.

Merits

Following are the benefits of retention of profit.

1. **Cheap Source of Capital :** No expenses are incurred when capital is available from this source. There is no obligation on the part of the company either to pay interest or pay back the money. It can safely be used for expansion and modernisation of business.

2. **Financial Stability :** A company which has enough reserves can face ups and downs in business. Such companies can continue with their business even in depression, thus building up its goodwill.

3. **Benefits to the Shareholders :** Shareholders are assured of a stable dividend. When the company does not earn enough profit it can draw upon its reserves for payment of dividends. Not only that their holding size can improve with issue of bonus shares. Due to reserves, there is capital appreciation, i.e., the value of shares may go up in the share market.

Limitations

Following are the limitations of retention of profit:

1. **High Profit Required :** This method of financing is possible only when the company earns huge profits and that too for many years.

2. **Dissatisfaction Among Shareholders :** Accumulation of profits often leads to low dividend payment by companies. Not only that, the companies may not utilise it for issue of bonus shares to avoid higher dividend payment. This may create dissatisfaction among the shareholders.

3. **Mis-management of Funds :** Capital accumulated through retained earnings encourages management to be less careful with utilisation of funds which may lead to low profitability. It is not in the long run interest of the shareholders.

15.8.7 Lease Financing

Lease is a contract whereby one can use the assets of the other with due permission of the owner on payment of rent without purchasing them. The owner of the asset is called 'lessor' and the user is called lessee. The period of use is called the lease period after which the lessee may opt for purchase of the asset.

So leasing is an arrangement that enables a business enterprise to use and exercise complete control over the assets without owning it. The owner gets rent in return and at any time as per the terms of the contract he can cancel the agreement. This system helps the business to use the plants and machinery and other fixed assets for a long period of time without investing a large amount of money in purchasing them. At the end of the lease period the asset goes back to the owner. The owner of the assets also has the option of selling it to the user at a reduced price. Sometimes the user company may request the leasing company to purchase its existing assets and allow them to use the same assets on lease basis. This enables the company to save the long-term funds that can be utilised for other purposes. This is known as 'sale and lease back' system.

15.8.8 Foreign Investment

Funds for the business can also be raised from foreign sources by means of Foreign Direct Investment (FDI). It can be obtained by collaborating with the foreign companies. It enables the Indian companies to secure equity capital through subscription of foreign collaborators to their share capital.

The companies can also take loan from International Financial Institutions like The World Bank and International Finance Corporation either directly or by way of refinancing.

Notes

The sale of shares to the persons of Indian origin and nationality, living abroad (Non-Resident Indians or NRIs) is another method of raising long-term funds of business. A non-resident Indian or a company controlled by non-resident Indians can invest within the prescribed limits of the paid up capital of an Indian company.

15.8.9 Global Depository Receipt

The issue of Global Depository Receipts (GDRs) and American Depository Receipts (ADRs) are different methods of raising funds from foreign sources. Under this method the shares of Indian companies are issued in the forms of depository receipts (Global or American) that are traded on the foreign markets.

Under GDR, shares of the company are first converted into depository receipts by an international banks. These depository receipts are denominated in US dollars. Then these depository receipts are offered for sale globally through foreign stock exchanges. The holder of GDRs are entitled for dividend just like shareholders. But they do not enjoy the the voting rights. many Indian companies like ICICI, Wipro etc. have raised foreign capital through issue of GDRs.

The depository receipts which are issued by a USA Bank for trading only in American Stock markets are known as American Depository Receipts (ADR). The ADRs are issued only to the American citizens.

INTEXT QUESTIONS 15.4

I. Give the full form of the following abbreviations:

(a) IFCI	(d) GDR
(b) SFC	(e) FDI
(c) SIDC	(f) ADR

II. Which method of long-term financing, Public Deposit or Retention of Profits, are being referred to, in each of the following statements:

(a) Management is less careful about funds utilization by this method.

(b) To raise funds through this method, an advertisement is generally given through the newspapers.

(c) They offers flexibility and the funds can be refunded when not required.

(d) They offer benefit to shareholders as company may draw upon them to pay dividend to them.

(e) No obligation on the company to pay interest on it or repay the money.

III. (a) How are funds raised through lease financing? Explain briefly, in your own words.

(b) List any two limitations of long-term borrowings from Commercial Banks.

WHAT YOU HAVE LEARNT

- Every business requires money to start and run the business. 'Business finance' refers to the money required for business purpose and the ways by which it is raised.
- Every business needs funds to purchase fixed assets to meet its day-to-day expenses, to fund business growth, bridge the time gap between production and sales, to meet contingencies and to avail of business opportunities.
- The importance of finance has considerably increased in modern times due to need for large-scale operation, use of modern technology and promotion of sales.
- Based on the period for which the funds are required, business finance is classified as:

  (a) Short-term finance (for a period of less than one year)

  (b) Medium-term finance (for one year to five years)

  (c) Long-term finance (for more than five years).
- There are two sources of raising the required funds by the business (i) internal sources – owner's capital, retained earnings, and (ii) external source-friends and relatives, banks, other financial institutions, money lenders, capital market, etc.
- Methods of raising short-term finance:

  1. Trade Credit
  2. Bank Credit – loans and advances, cash credit, bank overdraft, discounting of bills.
  3. Factoring
  4. Customers' advances
  5. Installment credit
  6. Loans for unorganised sectors
  7. Inter Coorporate Deposits

Notes

- The loans and advances are granted by the banks by taking some security that will ensure the bank about safe return of its money. Securities offered against bank credit may be of two types:

  (i) Personal security

  (ii) Security of assets like moveable goods, shares and stock, documents of title to goods, fixed deposit receipts, Life insurance policies, jewellery or precious metals etc.

- Small business in India is helpful by providing employment, supply variety of products, balanced regional growth, opportunity for entrepreneurship etc.

- The methods of raising long term finance are:

  (i) Issue of shares – Share is the smallest unit into which the total capital of the company is divided. There are mainly two types of shares.

    (a) Equity shares : They are shares which do not enjoy any preferential right in the matter of payment of dividend or repayment of capital. The equity shareholders get dividend only after making the payment of dividends on preference shares. There is no fixed rate of dividend for equity shareholders.

    (b) Preference shares : They carry preferential rights in respect of dividend and return of capital. The rate of dividend on preference shares is fixed.

  The different types of preference shares that a company can issue are:

    - Convertible and non-convertible preference shares
    - Cumulative and non-cumulative preference shares
    - Participating and non-participating preference shares, and
    - Redeemable and irredeemable Preference shares.

  (ii) Issue of Debentures : The companies also raise funds through debentures, which carry an assured rate of return for the investors. in the form of a fixed rate of interest. Debenture holders are the creditors of the company and are entitled to get interest irrespective of profit earned by the company. They do not have any voting right.

  (iii) Loan from Special Financial Institutions (SFI)

  (iv) Borrowings from Commercial Banks

  (v) Public Deposits

(vi) Retained Earnings

(vii) Lease Financing

(viii) Foreign Investment

(ix) Global Depository Receipts.

KEY TERMS

ADR	Bank Credit	Bank Overdraft
Capital Market	Cash Credit	Customer's Advance
Debenture	Discounting of Bill	Dividend
Equity Share	Factoring	Foreign Direct Investment
GDR	Internal Financing	Investment Trust
Lease	Long-term Finance	Medium-term Finance
Ploughing Back of Profits	Preference Share	Public Deposit
Retained Earnings	Share	Short-term Finance
Special Financial Institutions	Trade Credit	Trading on Equity
Working Capital	ICDs	

TERMINAL EXERCISE

Very Short Answer Type Questions

1. What is meant by 'Discounting of Bill'?
2. What is Trading on Equity?
3. What is meant by lease financing?
4. State the meaning of 'sale and lease back' system.
5. State the meaning of 'Preference shares'.
6. Define a Small Scale Enterprise as per 'MSMED Act, 2006.
7. Mention any two roles of small business in India.

Short Answer Type Questions

8. Distinguish between GDR and ADR.

Notes

9. ‘Finance is considered as the life-line of the business, especially in the modern day’. Give reasons for the same.
10. What do you mean by ICDs?
11. Enumerate different types of ICDs.
12. Define a Small Scale Enterprise as per ‘MSMED Act, 2006’.
13. Mention any five roles of small business in India.
14. Explain any two ways in which a business enterprise can obtain Bank Credit.
15. Give two merits and two limitations of equity shares, from the point of view of the management.
16. Explain the four types of preference shares that a company can issue.

Long Answer Type Questions

17. What are ‘Debentures’? Describe three merits and three limitations of debentures as a source of long-term finance for a company.
18. Differentiate between ‘Shares’ and ‘Debentures’ as sources of long-term finance.
19. What is meant by Special Financial Institutions (SFIs)? Explain two merits and two demerits of taking loans from SFIs as a source of long-term funds.
20. Briefly explain the different types of ICDs.
21. Describe the significance of small business in rural India.
22. Explain the main purposes for which business needs funds.
23. Write explanatory notes on:

    (a) Retention of Profits; and (b) Public Deposits,

    as methods of Long-term finance.

ANSWERS TO INTEXT QUESTIONS

15.1 I. (a) To purchase fixed assets
(b) To meet day-to-day expenses
(c) To fund business growth
(d) To bridge time gap between production and sales.
(e) To meet contingencies
(f) To avail of business opportunities.

II. (a) (i) purchase of raw material
(ii) payment of electricity bill (or any other suitable example)

(b) (i) modernisation and renovation
(ii) special promotional programmes (or any other suitable example)

(c) (i) purchase of land and building
(ii) purchase of furniture (or any other suitable example)

15.2 I. (a) Bill of Lading, Railway Receipts, Warehouse Warrant etc.
(b) Stock of raw material like leather, chemicals etc. or finished goods like industrial machinery, leather shoes etc. (or any other suitable examples).
(c) Gold Bangles, Diamond Necklace, Silver ware (or any other suitable examples).

II. (a) Bank Overdraft (b) Discounting of Bill
(c) Cash Credit (d) Loans and Advances.

III. (i) b

15.3 I. (a) Dividend is paid on these shares in preference to the equity shares.
(b) Share capital refunded only after the refund of preference share capital.
(c) Shareholders enjoy voting rights.
(d) Unpaid dividends are accumulated and are carried forward to the future years, in case of cumulative preference shares.

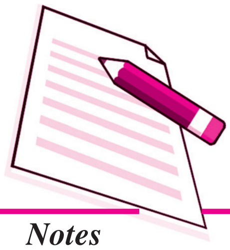
II. (i) Preference shares (ii) Debentures
(iii) Equity shares (iv) Equity shares
(v) Debentures

III.

Basis	*Shares*	*Debentures*
1. Status	Owners of the company	Creditors of the company.
2. Rights	Right to vote and determine policies of the company.	No right to attend company's meetings. No say in company's manage ment.
3. Security	Not required	Generally secured. So suf ficient fixed assets required to issue debentures.
4. Risk	High	Little risk

IV. (i) b (ii) b (iii) c

15.4 I. (a) Industrial Finance Corporation of India
(b) State Financial Corporation



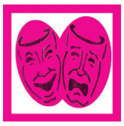
Notes

(c) State Industrial Development Corporation
(d) Global Depository Receipt
(e) Foreign Direct Investment
(f) American Depository Receipt

II. (a) Retained Earnings (b) Public Deposit
(c) Public Deposit (e) Retained Earnings
(f) Retained Earnings.

DO AND LEARN

Visit the branches of any two banks in your locality and find out from them about the various ways in which they provide finance to business enterprises. Find out about the types of securities the banks accept for such finance.



ROLE PLAY

Imran had started his garment business as a sole proprietor, with a capital of Rs. 25,000/-. Now, after two years, he has decided to form a company to run his expanding business. He approaches a financial consultant, Ms. Jyoti, to find out about the various sources from which he can obtain funds for a long term period for his company. Following is an extract from the conversation that took place between Imran and Jyoti, at Jyoti's office:

Imran : So ma'am, what are the ways in which I can get funds for the long-term, to meet the needs of my expanding business?

Jyoti : Mr. Imran, in today's times, you have a wide choice of financing options available to you. I would suggest you to weight the pros and cons of each of them and only then decide the source most suitable for the specific needs of your business.

Imran : Oh! It would be wonderful if you could throw some light on the various sources, since I do not know much about all this.

Jyoti : Yes, surely. The first one that comes to my mind is by approaching the capital market. This can be done in three ways-through issue of equity shares, preference shares and debentures.

Imran : Wait, wait. One by one please can you tell me about equity shares first.

Now, continue the conversation between these two people. You may take on Jyoti's part and ask one of your friends to play the role of Imran.

Through this role play, you can have fun and revise the various sources of long-term finance. Enjoy yourself.

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16

SOURCES OF LONG-TERM FINANCE

In the previous lesson you learnt about the various methods of raising long-term finance. Normally the methods of raising finance are also termed as the sources of finance. But, as a matter of fact the methods refer only to the forms in which the funds are raised, and hence may or may not include the sources from, or through which the funds are raised. Hence, we must also have an idea about the sources of finance. You will recall that the various sources of long-term finance had been duly identified in the previous lesson. We shall now learn in detail about those sources.

OBJECTIVES

After studying this lesson, you will be able to:

- identify the various sources of long-term finance;
- explain the meaning and importance of capital market;
- identify the special financial institutions in India;
- describe the nature and role of special financial institutions;
- explain the concept of mutual funds;
- describe the role of leasing companies;
- identify the foreign sources of long-term finance and
- explain the importance of retained earnings as a source of long-term finance.

16.1 SOURCES OF LONG-TERM FINANCE

The sources of long-term finance refer to the institutions or agencies from, or through which finance for a long period can be procured. As stated earlier, in case of sole

Notes

proprietary concerns and partnership firms, long-term funds are generally provided by the owners themselves and by the retained profits. But, in case of companies whose financial requirement is rather large, the following are the sources from, or through which long-term funds are raised.

(a)	Capital Market	(b)	Special Financial Institutions
(c)	Mutual Funds	(d)	Leasing Companies
(e)	Foreign Sources	(f)	Retained Earnings

16.2 CAPITAL MARKET

Capital market refers to the organisation and the mechanism through which the companies, other institutions and the government raise long-term funds. So it constitutes all long-term borrowings from banks and financial institutions, borrowings from foreign markets and raising of capital by issuing various securities such as shares debentures, bonds, etc. For trading of securities there are two different segments in capital market. One is primary market and the other is, secondary market. The primary market deals with new/fresh issue of securities and is, therefore, known as **new issue market**. The secondary market on the other hand, provides a place for purchase and sale of existing securities and is known as **stock market** or **stock exchange**.

The new issue market primarily consists of the arrangements, which facilitate the procurement of long-term finance by the companies in the form of shares, debentures and bonds. The companies usually issue those securities at the initial stages of their formation and so also later on for expansion and/or modernization of their activities. However, the selling of securities is not an easy task, as the companies have to fulfill various legal requirements and decide upon the appropriate timing and the method of issue. Hence, they seek assistance of various intermediaries such as merchant bankers, underwriters, stock brokers etc. to look after all these aspects. All these intermediaries form an integral part of the primary market.

The secondary market (stock exchange) is an association or organisation or a body of individuals established for the purpose of assisting, regulating and controlling the business of buying, selling and dealing in securities. It may be noted that it is called a secondary market because only the securities already issued can be traded on the floor of the stock exchange. This market is open only to its members, most of whom are brokers acting as agents of the buyers and sellers of securities. The main functions of this market lie in providing liquidity (ready encashment) to securities and safety in dealings. It is because of the availability of such facilities that people are ready to invest in securities. We shall learn more about the capital market in lesson no. 18.

16.3 SPECIAL FINANCIAL INSTITUTIONS (SFI)

A number of special financial institutions have been set up by the central and state governments to provide long-term finance to the business organisations. They also offer support services in launching of the new enterprises and so also for expansion and modernisation of existing enterprises. Some of the important ones are Industrial Finance Corporation of India (IFCI), Industrial Investment Bank of India (IIBI), Industrial Credit and Investment Corporation of India (ICICI), Industrial Development Bank of India (IDBI), Infrastructure Development Finance Company Ltd. (IDFC), Small Industries Development Bank of India (SIDBI), State Industrial Development Corporations (SIDCs), and State Financial Corporations (SFCs), etc. Since these institutions provide developmental finance, they are also known as **Development Banks** or **Development Financial Institutions (DFI)**. Besides these development banks there are a few other financial institutions such as life Insurance Corporation of India (LIC), General Insurance Corporation of India (GIC) and Unit Trust of India (UTI) which provide long-term finance to companies and subscribe to their share and debentures. The main functions of these institutions are:

(i) to grant loans for a longer period to industrial establishment;

(ii) to help the establishment of business units that require large amount of funds and have long gestation period;

(iii) to provide support for the speedy development of the economy in general and backward regions in particular;

(iv) to offer specialized services operating in the areas of promotion, project assistance, technical assistance services and training and development of entrepreneurs and

(v) to provide technical and professional management services and help in identification, evaluation and execution of new projects.

INTEXT QUESTIONS 16.1

1. Distinguish between new issue market and stock exchange. (Give one point)

2. Give the full form of the following abbreviation.

   (a) DFI

   (b) IIBI

   (c) SIDBI

   (d) SFI

   (e) IFCI

Let us have a brief idea about some of the Special Financial Institutions.

1. **Industrial Finance Corporation of India (IFCI) :** It is the oldest SFI set up in 1948 with the primary objective of providing long-term and medium-term finance to large industrial enterprises. It provides financial assistance for setting up of new industrial enterprises and for expansion or diversification of activities. It also provides support to modernisation and renovation of plant and equipment in existing industrial units. It can grant loan or subscribe to debentures issued by companies repayable in not more than 25 years. It can also guarantee loans raised from other sources or debentures issued to the public, and take up underwriting of the public issue of shares and debentures by companies. For ensuring greater flexibility to meet the needs of the changing financial system IFCI now stands transformed to IFCI Ltd. with effect from 1 June 1993.

2. **Industrial Credit and Investment Corporation of India (ICICI) :** It was set up in 1955 for providing long-term loans to companies for a period upto 15 years and subscribe to their shares and debentures. However, the proprietary and partnership firms were also entitled to secure loans from ICICI. Like IFCI, the ICICI also guarantees loans raised by companies from other sources besides underwriting their issue of shares and debentures. Foreign currency loans can also be secured by companies from ICICI. In the context of the emerging competitive scenario in the finance sector, ICICI has merged with ICICI Bank Ltd., with effect from 3 May 2002. Consequent upon the merger, the ICICI group's financing and banking operations have been integrated into a single full service banking company.

3. **Industrial Development Bank of India (IDBI) :** It was set up in 1964 as a subsidiary of Reserve Bank of India for providing financial assistance to all types of industrial enterprises without any restriction on the type of finance and the amount of funds. It could also refinance loans granted by other financial institutions and offer guarantees for the loans raised from the capital market or scheduled banks. It also discounts and rediscounts the commercial bills of exchange and undertakes underwriting of the public issues. IDBI, like ICICI, has also transformed into a commercial bank and has been retitled as IDBI Ltd. with effect from 1 October 2004 with IDBI Bank merged into it.

4. **Industrial Investment Bank of India (IIBI) :** The erstwhile Industrial Reconstruction Bank of India (IRBI), an institution which was set up for rehabilitation of small units has been reconstituted in 1997 as Industrial Investment Bank of India. It is a full fledged all purpose development bank with adequate operational flexibility and autonomy. After the reconstruction its focus has changed from rehabilitation finance to development banking.

Notes

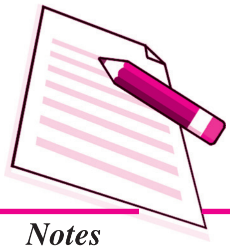
5. **Small Industries Development Bank of India (SIDBI) :** It was set up in 1990 as a principal financial institution for the promotion, financing and development of small-scale industrial enterprises. It is an apex institution of all the banks providing credit facility to small-scale industries in our country. It offers refinancing of bills, rediscounting of bills, and several other support services to Small Scale Industries (SSI). It undertakes a wide range of promotional and development activities for improving the inherent strength of SSI units and creating avenues for the economic development of the rural poor.

6. **State Financial Corporations (SFCs) :** In order to provide financial assistance to all types of industrial enterprises (proprietary and partnership firms as well as companies) most of the states of our country have set up SFCs. The primary objective of these corporations is to accelerate the pace of industrial development in their respective states. SFCs provide finance in the form of long-term loans or through subscription of debentures, offer guarantee to loans raised from other sources and take up underwriting of public issues of shares and debentures made by companies. However, they cannot directly subscribe to the shares issued by the companies. The SFC (Amendment) Act, 2000 has provided greater flexibility to SFCs to cope with the changing economic and financial environment of the country.

7. **State Industrial Development Corporations (SIDCs) :** These corporations were set up in 1960s and early 1970s by most state governments for promotion and development of medium and large-scale industries in their respective states. In addition to providing financial assistance to industrial units, they also undertake a variety of promotional activities. They also implement the various incentive schemes of the central and state governments.

8. **Other Financial Institutions :** Apart from the above special financial institutions, there are a few other organizations, which act as important source of long-term finance. These are:

   (a) ***Life Insurance Corporation of India (LIC) :*** It was set up in 1956 on nationalisation of life insurance business in India. Primarily it carries on the business of life insurance and deploys the funds in accordance with national priorities and objectives. It invests mainly in government securities and shares, debentures and bonds of companies. It also extends financial assistance to banks and other institutions for social development and infrastructure facilities. It also underwrites new issues of shares and grant loans to the corporate sectors. Its performance with regard to assistance to corporate sector has been significant both in terms of sanctions and disbursements.



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(b) ***General Insurance Corporation of India (GIC) :*** It was established in 1973 on nationalization of general insurance business in India. Like LIC, its investment priority is socially oriented sectors of the economy, and invests its funds in government securities and shares and debentures of companies. It also provides term loans and underwriting facility to new and existing industrial undertakings.

(c) ***Unit Trust of India (UTI) :*** It was set up in 1964 as an investment trust with capital of Rs. 5 crore subscribed by Reserve Rank of India, LIC, State Bank of India and other financial institutions. It has been playing an important role in mobilizing the savings of the community through sale of units under various schemes (most well known being US-64 and master shares) and channalising them into corporate investments. It has also been extending financial assistance to the companies by way of term loans, bills rediscounting, equipment leasing and hire purchase financing.

(d) ***Export and Import Bank of India (EXIM Bank) :*** The Export and Import Bank of India was set up in January, 1982 to take over the operations of international finance wing of the IDBI and act as an apex institutions in the field of financing foreign trade. The main functions of the Bank are: (i) financing of export and import of goods and services; (ii) granting deferred payment credit for medium and long term duration; (iii) providing loans to Indian parties to enable them to contribute to share capital of joint ventures in foreign countries and; (iv) extending refinance facilities to commercial banks in respect of export credit. Recently it has introduced production equipment finance programme under which it provides rupee term finance to export oriented units for acquisition of equipment. Apart from these, the Exim Bank also undertakes merchant banking and development banking functions as considered necessary to finance promotional activities and providing counseling services to persons engaged in export-import business.

(e) ***Venture Capital Institutions :*** Venture Capital is a form of equity finance designed specially for funding high risk and high reward projects of young entrepreneurs. It helps them to turn their research and development projects into commercial ventures by providing them the initial capital and managerial assistance. The initial capital is provided in the form of equity participation through direct purchase of the shares and debentures of the enterprise set up for the purpose. The institutions providing venture capital also actively participate in the management of the entrepreneurs' business. By actively involving and supporting the enterprises, they are able to protect and enhance the value of their investment.

The development of venture capital institutions is of recent origin in India. The concept was formally introduced in 1986-87 when the Government announced the creation of a venture fund to be operated by IDBI. It was followed by ICICI, IFCI and two public sector banks (State Bank of India and Canara Bank) who set up separate companies for the purpose. Some state government controlled development financial institutions viz., Gujarat Industrial Investment Corporation and Andhra Pradesh State Corporation also promoted their venture capital companies. In 1992-93, SIDBI also set up a venture capital fund for providing financial assistance for innovative ventures in small-scale sector.

INTEXT QUESTIONS 16.2

1. State the meaning of Venture Capital
2. Mention the year in which following financial institutions were established.
   (a) IIBI
   (b) LIC
   (c) EXIM Bank
   (d) GIC
   (e) SIDBI

16.4 BANKS

In the previous lesson you learnt that commercial banks usually provide short-term finance to business firms in the form of loans and advances, cash credit, overdraft etc. But now-a-days, most of the commercial banks have also started term lending (long and medium term) and providing need based finance of different time periods to firms of all sizes. Consistent with the policy of liberalization, the banks have been allowed to evolve their own methods of assessing financial needs of the borrowers and extend them the term loans for larger size and longer periods. Some of the banks have also started their industrial branches to finance exclusively to industrial enterprises. Thus, the commercial banks also now act as an important source of medium term and long term finance for the business.

You know that a large number of cooperative banks are now operating in our country. These banks have the license from the RBI to operate like commercial banks. They also some times provide long-term finances to small and medium scale cooperative industrial units like Sugar factories, food-processing units etc.

16.5 NON-BANKING FINANCIAL COMPANIES (NBFCS)

You must have heard about various housing finance companies, investment companies, vehicle finance companies etc. operating in private sectors different parts of our country. These companies are categories under Non-Banking Financial Companies, because they perform the twin functions of accepting deposits from the public and providing loans. However they are not regarded as banking companies as they do not carry on the normal banking activities. They raise funds from the public by offering attractive rate of interest and give loans mainly to the wholesale and retail traders, small-scale industries and self-employed persons. The loans granted by these finance companies are generally unsecured and the interest charged by them ranges between 24 to 36 percent per annum. Besides giving loans and advances, the NBFCs also have purchase and discount hundis, undertaken merchant banking, housing finance, lease financing, hire purchase business etc. In our country, NBFCs have emerged as an important financial intermediary due to simplified loan sanction procedure, attractive rate of return on deposits, flexibility and timeliness in meeting the credit needs of the customers.

16.6 MUTUAL FUNDS

Mutual fund refers to a fund established in the form of a trust by a sponsor to raise money through one or more schemes for investing in securities. It is a special type of investment institution, which acts as an investment intermediary that collects or pools the savings of a large number of investors and invests them in a fairly large and well diversified portfolio of sound investments. This minimizes their risk and ensures good returns to the investors. Thus, they act as an investment agency for small investors and a good source for long-term finance for the business.

16.6.1 Features of Mutual Funds

The essential features of mutual funds are as follows:

1. It is a trust into which a number of investors invest their money in the form of units to form a large pool of funds.
2. The amount is invested in securities by the managers of the fund.
3. The amount is invested in different securities of reputed companies to ensure definite and regular income. Thus, it helps in minimizing the risk.
4. The mutual fund schemes often have the advantages of high return, easy liquidity, safety and tax benefits to the investors.
5. The net income received on the investments of the fund is distributed over the units held.
6. The managers of the fund are obliged to redeem the units on demand or on the expiry of a specified period.

16.6.2 Types of Mutual Funds

Keeping in view the investment objectives of the investors the mutual funds usually have a large variety of schemes such as equity fund, debt fund, balanced fund, growth fund, income fund, liquid fund, tax saver fund, index fund and so on. These schemes are broadly classified into two categories as follows:

(a) **Open Ended Funds :** These funds have no fixed corpus and period. Such fund continuously offer units for sale and is ready to buy back the units surrendered. In other words, investors are free to buy from, or sell to, the trust any number of units at any point of time at prices which are linked to the net asset value (NAV) of the units.

(b) **Close Ended Funds :** In case of these funds, subscriptions from the investors are collected during a specified time period and have a fixed corpus. Not only that, the investors cannot redeem their units till the specified maturity date. However, to provide liquidity, these are listed on the stock exchange and the investors can purchase and sell through the brokers at the market price without any difficulty.

It may be noted that Unit Trust of India was the first mutual fund started in India as early as 1964. Later, LIC, GIC and some nationalised banks also launched their mutual funds with high degree of success. However, during post liberalisation era, many private sector mutual funds have entered the fray. To mention a few, these are: Birla Sun Life, HDFC, HSBC, ICICI Prudential, DSP Merrill Lynch, DBS Chola Mutual Fund.

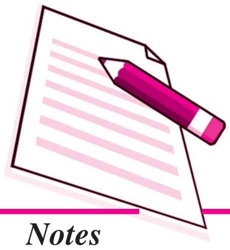
INTEXT QUESTIONS 16.3

1. Mention the source of finance of NBFCs.
2. What is Net Asset Value?
3. List the advantages of Mutual funds.

16.7 LEASING COMPANIES

You learnt about leasing arrangement as a method of long-term finance in the previous unit. This method has become quite common among the manufacturing companies. Leasing facility is usually provided through the mediation of leasing companies who buy the required plant and machinery from its manufacturer and lease it to the company that needs it for a specified period on payment of an annual rent.

For this purpose a proper lease agreement is made between the lessor (leasing company) and lessee (the company hiring the asset). Such agreement usually provides for the purchase of the machinery by the lessee at the end of the lease period at a mutually agreed and specified price. It may be noted that the ownership remains with the leasing company during the lease period.



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Sometimes, a company, to meet its financial requirements, may sell its own existing fixed asset (machinery or building) to a leasing company at the current market price on the condition that the leasing company shall lease the asset back to selling company for a specified period. Such an arrangement is known as 'Sell and Lease Back'. The company in such arrangement gets the funds without having to part with the possession of the asset involved which it continues to use on payment of annual rent for the lease.

It may be noted that in any type of leasing agreement, the lease rent includes an element of interest besides the expenses and profits of the leasing company. In fact, the leasing company must earn a reasonable return on its investment in lease asset.

The leasing business in India was started, in seventies when the first leasing company of India was promoted by Chitambaram Group in 1973 in Chennai. The Twentieth Century Finance Company and four other finance companies joined the fray during eighties. Now their number is very large and leasing has emerged as an important source. It is very helpful for the small and medium sized undertakings, which have limited financial resources.

16.8 FOREIGN SOURCES

Foreign Sources also play an important part in meeting the long-term financial needs of the business in India. These usually take the form of (1) external borrowings; (2) foreign investments and; (3) deposits from NRIs. Let us have a brief idea about these sources.

1. **External Borrowings :** These include loans obtained at concessional rates of interest with long maturity period and commercial borrowings. The major sources of concessional loans have been the International Monetary Fund (IMF), Aid India Consortium (AIC), Asian Development Bank (ADB), World Bank (International Bank for Reconstruction and Development) and International Financial Corporation. The World Bank grants loans for specific industrial projects of high priority and given either directly to an industrial concern or through a government agency. The International Finance Corporation, an affiliate of the World Bank, grants loans to industrial units for a period of 8 to 10 years. Such loans do not require government guarantee.

   As for the external commercial borrowings, their major sources have been the export credit agencies like US Exim Bank, the Japanese Exim Bank, Export Credit and Guarantee Corporation of U.K. and other government and multilateral agencies. The external commercial borrowings are permitted by the government as an important source of finance for Indian firms for the expansion investments.

Notes

2. **Foreign Investments :** The foreign investments in our country are generally done in the form of foreign direct investment (FDI) or through foreign collaborations. The foreign direct investment usually refers to the subscription by the foreigners to shares and debentures of the Indian Companies. This is also known as portfolio investment and covers their subscription to ADRs, GDRs and FCCBs (Foreign Currency Convertible Bonds).

   Alternatively, some companies are formed with the specified purpose of operating in India or the multinationals can set up their subsidiary or branch in India. As for the foreign collaborations, these can be of financial collaborations involving foreign companies participation in equity capital of an existing or new undertaking. The technical collaborations are by way of supply of technical knowledge, patents and machineries. To start with, the technical collaborations had been the more popular form in the past. But during the post liberalisation phase, shift from technical collaborations to financial collaborations is noticed in our country.

   It may be noted that the government has been very successful in attracting more foreign investment in the post liberalisation era. It is because the Government of India now permits automatic approval of foreign investment upto 51% equity in 34 industries and a special board (Foreign Investment Promotion Board) has been set up to process cases not covered by automatic approvals. The main advantage of foreign investment is that generally the foreign investor also brings with him the technical expertise and the modern machinery. The disadvantage, however, is that a large part of profits are transferred to the foreign investors.

3. **Non-resident Indians (NRIs) :** You are aware that the persons of Indian origin (PIO) living abroad commonly known as Non-Resident Indians (NRIs) constitute an important source of long-term finance for industries in India. The most common form of their contribution is in the form of deposits under Foreign Currency Non-Resident Account (FCNRA) and Non-Resident (External) Rupee Account (NRERA). It is worth noting that the share of NRI deposits in the total foreign capital flows (net) was 26.7% during the year 2001-02. However, like external borrowing, NRI deposits are high cost source of external finance and are fair weather friends. Hence, too much dependence on NRI deposits is not a right policy. It may be noted that they are also permitted to subscribe to the shares and debentures of the companies in India, and have the option of selling them and take back the amount. This constitutes an integral part of foreign direct investment.

16.9 RETAINED EARNINGS

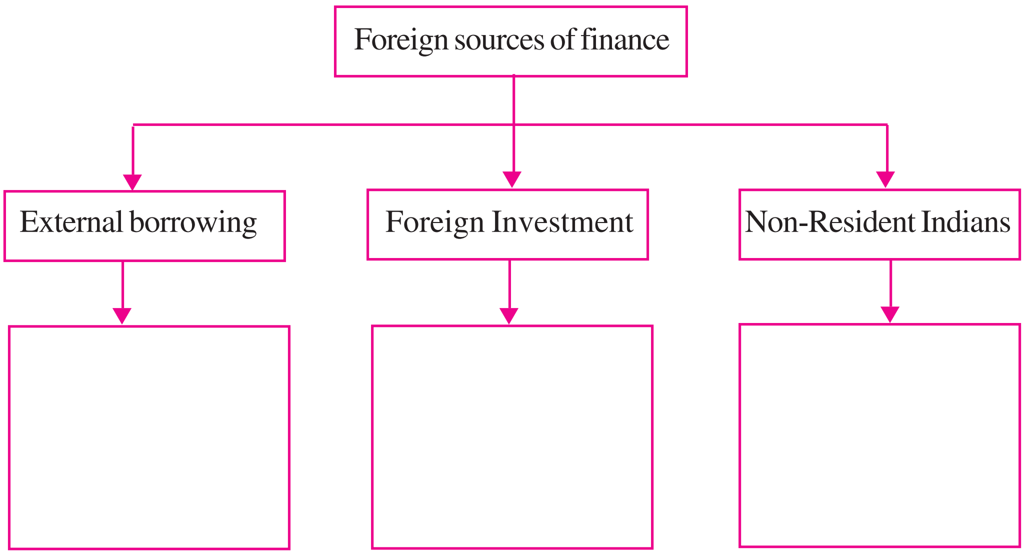
You know that retained earnings refer to the undistributed profits of companies which is usually kept in the form of general reserve. Primarily, it is a hedge against low profits in future and is used for the issue of bonus shares by the company. But, in effect, it acts as an important source of long-term finance for the companies with Zero cost of capital. The retained profits can be used for expansion and modernization programmes by the companies. The amount of retained earnings is determined by the quantum of profits, the dividend payout policy followed by the management, the legal provisions for dividend payment, and the rate of corporate taxes etc.

It is an internal source, which does not involve any cost of floatation and the uncertainties of external financing. In fact, it is regarded as the most dependable source of long-term finance. It also strengthens the firm's equity base, which enables to borrow at better terms and conditions. The main drawbacks of this source are (a) it is fully dependent on the accuracy of profits; and (b) possibility of reckless use of funds by the management.

INTEXT QUESTIONS 16.4

1. Name the two parties of lease agreement.
2. Categorise the following under three headings of foreign sources of finance.

   (a) ADB (b) ADR (c) FCNRA (d) AIC
   (e) PIO (f) NRERA (g) FCCB



WHAT YOU HAVE LEARNT

- The institutions or agencies from or through which finance for a Long period is obtained are termed as sources of long-term finance. Capital market, special financial institution, banks, non-banking financial companies, retained earnings and foreign investment and external borrowings are the main sources of long-term finances for companies.

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Sources of Long-term Finance

- The companies raise long-term funds by issuing shares and debentures through securities market. This market is divided into two parts – (a) new issue market, in which new securities are issued; and (b) stock exchange, in which existing securities are traded.
- To provide long-term finance and other support services to industrial enterprise, special financial institution (SFI) have been set up by central and state governments some of the important SFIs are IFCI, ICICI, IIBI, IDBI, SIDBI, SFCs, SIDCs etc. Besides these SFIs, there are few other financial institutions such as LIC, GIC, UTI, etc EXIM Bank, Venture Capital Institutions also provide long-term finance and other support to business enterprises.
- Commercial banks and Co-operative banks also provide long and medium finance to enterprises.
- There are number of Finance Companies operating in private sectors who accept deposits form the public and give Long-term loans to business enterprises. These companies are know a Non-Banking Financial Companies. Because of their simplified loan sanction procedure, flexibility and quick services, NBFCs have emerged as an important source of finance.
- Mutual Funds act as an investment intermediary that collects the savings of a large number of investors and invest them in big companies. This minimises the risk of the investors and ensures them good return. To attract the investors. Mutual fund companies offer different schemes which are categoried under open ended schemes and close ended schemes.
- The leasing companies also extend long term support in the form of providing plants and machineries, building, land etc. on rent basis. The business firms can avail this facility without blocking huge capital in buying the assets.
- Foreign sources take the form of (a) External borrowings; (b) Foreign investments; and (c) Non-resident Indians.
- The undistributed profits of the company which is kept for future use constitute a major source of long-term finance. It does not involve any cost of floatation and it strengthens the firm's equity base.

KEY TERMS

Capital Market	Leasing	New Issue Market
Retained Earnings	Stock exchange	Development Finance Corporation
Special Financial Institutions	NRI	Venture Capital
Corpus	NBFCs	Net Asset Value
Mutual Funds		

Notes

TERMINAL EXERCISE

Very Short Answer Type Questions

1. What is meant by Stock Market?
2. Name any two special financial institutions.
3. Mention any two features of Mutual Funds.
4. Distinguish between Open ended and close ended types of Mutual Funds.
5. State the meaning of 'Foreign Direct Investment'.

Short Answer Type Questions

6. State any two functions of EXIM bank.
7. What are the main functions of special financial institutions?State.
8. Explain, how LIC of India provides support to business sectors in solving long-term requirement of funds.
9. Explain the role of NBFCs in providing long-term finance.
10. Mention the merits and demerits of 'Retained Earnings' as a source of long-term finance.

Long Answer Type Questions

11. Explain 'Capital Market' as a source of Long-term finance.
12. Name any three special financial institutions and state their objectives.
13. Describe the role of venture capital institutions in providing long term finance to business.
14. What is meant by 'Mutual Funds'? Explain its features in brief.
15. Describe 'External borrowings' as a form of getting funds from foreign sources.

ANSWERS TO INTEXT QUESTIONS

16.1

1. In new issue market deals with new issue of securities, where as in stock exchange existing securities are traded.

2. (a) Development Financial Institutions
   (b) Industrial Investment Bank of India
   (c) Small Industries Development Bank of India
   (d) Special Financial Institutions
   (e) Industrial Finance Corporation of India

16.2 1. Venture capital is a form of equity finance designed specially for funding high risk and high reward projects of young entrepreneurs.

2. (a) 1997 (b) 1956 (c) 1982
(d) 1973 (e) 1990

16.3 1. Public Deposits

2. The price at which a unit of mutual fund is bought and sold

3. (a) High return (b) Easy liquidity
(c) Safety (d) Tax benefits

16.4 1. (a) Lessor (b) Lessee

2. Foreign sources of Finance

- External borrowings
  - ADB
  - AIC
- Foreign Investment
  - ADR
  - FCCB
- Non-Resident Indians
  - FCNRA
  - PIO
  - NRERA

DO AND LEARN

You are required to collect the following information from the newspaper and record the same.

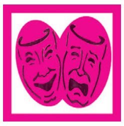
(a) Name of the Mutual Fund Companies (at least 5 to 10 companies)

(b) The schemes issued

(c) Whether open end or closed end.

(d) Value of the unit (Market Price)

(e) Any other information you can



ROLE PLAY

The Chamber of Commerce of your town has organised a discussion on the 'Long-term need of finance'. Your friend Madan, who runs a big readymade garments shop, is a member of that Chamber of Commerce. Knowing that you are a student of Business Studies he has suggested your name to be an expert to deliver a lecture on "Role of Special Financial Institutions in providing long-term finance". You are required to prepare your lecture and present it first before your friends.

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17

FINANCIAL MANAGEMENT

You know that every business unit whether it is an industrial establishment, a trading concern or a construction company needs funds for carrying on its activities successfully. It requires funds to acquire fixed assets like machines, equipments, furnitures etc. and to purchase raw materials or finished goods, to pay its creditors, to meet its day-to-day expenses, and so on. In fact, availability of adequate finance is one of the most important factors for success in any business. However, the requirement of finance, now-a-days, is so large that no individual is in a position to provide the whole amount from his personal sources. So the businessman has to depend on other sources and use various ways to raise the necessary amount of funds. In the previous lessons you learnt about the sources and methods of raising funds. You know that the process of raising funds require considerable amount of time and cost. This has its own costs. Hence, every businessman has to be very careful not only in assessing the firm's requirement of finance but also in deciding on the forms in which funds are raised and utilised. In this lesson, you will learn about the process of estimating the firm's **financial requirement** and deciding on the **pattern of finance**.

OBJECTIVES

After studying this lesson, you will be able to:

- state the objectives of financial management.
- understand the meaning of different types of financial decisions.
- state the meaning and objectives of financial planning;
- explain the concepts of fixed and working capital;
- identify the determinants of fixed and working capital;


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- explain the meaning and importance of capital structure;
- identify the determinants of capital structure and
- explain the meaning and factors in determining dividend.

17.1 OBJECTIVES OF FINANCIAL MANAGEMENT

The main objective of financial management is to maximize the wealth of shareholders. The other important objectives of financial management are:

1. To provide maximum returns to the owners on their investment.
2. To ensure continuous availability of sufficient funds at reasonable cost.
3. To ensure effective utilisation of funds.
4. To ensure safety of funds.

Decisions Relating to Investment, Financing and Dividend

1. **Investment Decision :** This decision involves careful selection of assets in which funds have to be invested. Decision relating to investment in fixed assets [capital budgeting] and decision relating to investment in current asset [working capital] are considered here.

   Investment decisions are influenced by cash flow, risk involved, technological changes etc.

2. **Financing Decision :** This decision relates to the proportion in which funds are raised from various sources. Factors like cost of fund, risk involved, control, cash flow etc. are considered before taking financial decision. In financing decision the firm has to decide the ratio of owned funds and borrowed funds. Owned funds consists of equity share capital, preference share capital and retained earnings. Borrowed funds include debentures, loans and public deposits etc.

3. **Divided Decision :** This decision is concerned with appropriation of earned profits. This profit of the firm can be retained in the business or can be distributed to the share holders as dividend. A company has to decide how much profits should be distributed as dividend and how much should be retained for future business growth. Factors affecting dividend decision are cash flow position, stability of earnings, growth opportunities etc.

INTEXT QUESTIONS 17.1

1. A company plans to buy a latest machine which operates on new technology in order to replace an old and outdated machine. Identify the type of decision involved

   a) Investment decision　　b) Financial decision

   c) Dividend decision　　d) All of the above

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2. A company decided to distribute a portion of the profits earned in the previous years among its shareholders. Identity the type of decision involved.

   a) Financial decision b) Investment decision

   c) Dividend decision d) All of the above

3. A company assured the funds required to execute an expansion programme. Identify the decision made by the company.

   a) Financial decision b) Investment decision

   c) Dividend decision d) None of the above

17.2 FINANCIAL PLANNING

You know that planning is a systematic way of deciding about and doing things in a purposeful manner. When this approach is applied exclusively for financial matter, it is termed as financial planning. In connection with any business enterprise, it refers to the process of estimating a firm's financial requirements and determining pattern of financing. It includes determing the objectives, policies, procedures and programmes to deal with financial activities. Thus, financial planning involves:

(a) estimating the amount of capital to be raised;

(b) determining the pattern of financing i.e., deciding on the form and proportion of capital to be raised;

(c) and formulating the financial policies and procedures for procurement, allocation and effective utilisation of funds.

After knowing what is financial planning let us now learn its objectives.

17.2.1 Objectives of Financial Planning

The main objectives of financial planning are:

(a) To ascertain the amount of fixed capital as well as the working capital required in a given period.

(b) To determine the amount to be raised through various sources using a judicious debt-equity mix.

(c) To ensure that the required amount is raised on time at the lowest possible cost.

(d) To ensure adequate liquidity so that there are no defaults in payments and all contingencies (any unforseen expenditure) are met without difficulty.

(e) To ensure optimal use of funds so that the business is neither starved of funds nor has unnecessary surplus funds at any point of time.

17.2.2 Essentials of a Sound Financial Plan

While preparing a financial plan for any business unit, the following aspects should be kept in view so as to ensure the success of such exercise in meeting the organisational objectives.

(a) **The plan must be simple :** Now-a-days you have a large variety of securities that can be issued to raise capital from the market. But it is considered better to confine to equity shares and simple fixed interest debentures.

(b) **It must take a long term view :** While estimating the capital needs of a firm and raising the required funds, a long-term view is necessary. It ensures that the plan fully provides for meeting the capital requirement on long term basis and takes care of the changes in capital requirement from year to year.

(c) **It must be flexible :** While the financial plan is based on long term view, one may not be able to properly visualise the possible developments in future. Not only that, the firm may also change its plans of expansion for various reasons. Hence, it is very necessary that the financial plan is capable of being adjusted and revised without any difficulty and delay so as to meet the requirements of the changed circumstances.

(d) **It must ensure optimal use of funds :** The plan should provide for raising reasonable amount of funds. As stated earlier, the business should neither be starved of funds nor have surplus funds. It must be strictly need based and every rupee raised should be effectively utilised. There should be no idle funds.

(e) **The cost of funds raised should be fully taken into account and kept at the lowest possible level :** It must be ensured that the cost of funds raised is reasonable. The plan should provide for a **financial mix** (combination of debt and equity) that is most economical in terms of cost of capital, otherwise it will adversely affect the return on shareholders' funds.

(f) **Adequate liquidity must be ensured :** Liquidity refers to the ability of a firm to make available the necessary amount of cash as and when required. It has to be ensured in order to avoid any embarrassment to the management and the loss of goodwill among the investors. In other words, the investment of funds should be so planned that some of these can be converted into cash to meet all possible eventualities.

17.2.3 Importance of Financial Planning

1. It helps to estimate accurate requirement of funds.
2. It facilitates in developing a sound capital structure which gives maximum returns to shareholders.

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3. It helps in proper utilisation of funds.
4. It tries to avoid the shortage of funds and surplus of funds.
5. It provides policies and procedures for coordinating different departments of an enterprise.
6. It acts as a basis to control the financial activities of an organisation.
7. It helps to face unforeseen financial situations in the business.

INTEXT QUESTIONS 17.2

1. Define 'Financial Planning' in your own words.
2. Which of the following are not the essential characterstics of financial planning?
   (a) Simplicity
   (b) Liquidity
   (c) Abudant availability of funds
   (d) Flexibility
   (e) Concentration on long term needs only
   (f) Economy
3. State whether the following are objectives of financial planning, by writing 'Yes' or 'No'.
   (a) Determining the requirement of fixed and working capital . (   )
   (b) Determining the sales output. (   )
   (c) To ensure the timely availability of funds. (   )
   (d) To determine the quantity of production. (   )
   (e) To raise funds at the lowest possible cost. (   )

17.3 TYPES OF CAPITAL REQUIREMENT

The capital requirement of any business unit can be broadly divided into two categories: (a) fixed capital requirement, and (b) working capital requirement. In order to ascertain the amounts of such requirements for any business, one must understand the exact nature of fixed and working capitals and also the various factors that influence their requirement.

17.3.1 Fixed Capital

Fixed capital represents the requirement of capital for meeting the permanent or long-term financial needs of the business. It is primarily used for acquiring the fixed assets like land and buildings, plant and machinery, office equipment, furniture and fixtures etc. Fixed capital is required not only while establishing a new enterprise but also for meeting expansion requirement in the existing enterprises. The amount of such requirement can be assessed by preparing a list of fixed assets needed by the business unit and ascertaining their prices from the market.

It may be noted that investment in fixed assets is a long-term commitment and the amount so invested cannot be withdrawn quickly. Hence, the funds for such requirement are always provided from owners' fund or raised by issuing shares and debentures and taking long-term loans from financial institutions.

17.3.2 Factors Determing Fixed Capital Requirement

In order to assess the fixed capital requirement for any business enterprise, one must be fully conversant with the factors that influence such requirement. These factors are summarised as follows:

(a) **Nature of business :** The amount of fixed capital requirement is determined primarily by the nature of business the firm is engaged in. Such requirement, for example, is very large in case of industrial establishments, shipping companies, public utilities, etc. which involve heavy investment in plant and machinery. The trading concerns (wholesalers and retailers) do not require much investment in the fixed assets.

(b) **Type of products :** It is not only the nature of business which determines the requirement of fixed capital but also the type of product involved. A firm manufacturing simple products like soap, toothpaste, stationery, etc. requires small amount of fixed capital as against the firms producing items like steel, cement, automobiles, etc.

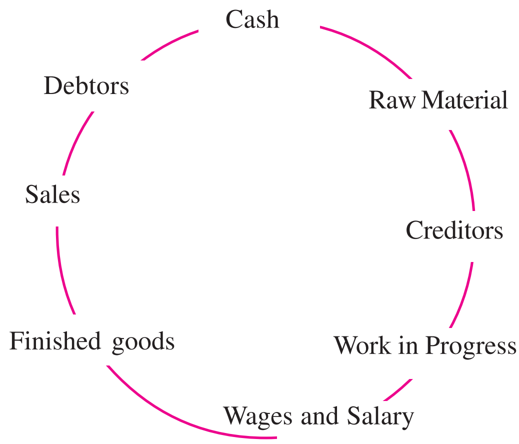
(c) **Size of business :** A firm working on a large scale requires heavy investment in fixed assets as it has to establish large production capacity. Hence, its fixed capital requirement is larger than a firm which is operating on a small scale.

(d) **Process of Production :** A firm which goes in for an automatic plant requires larger amount of fixed capital as compared to the firm which selects semi-automatic plant or depends more on manual labour for production of goods. Similarly, if a firm decides to buy most of the components needed for its products from the market rather than producing these in its own factory, it would need less fixed capital as compared to the one which manufactures each component (part) on its own. This is specially true of those automobile and machinery producers who simply act as assembling units.

(e) **Method of acquiring fixed assets :** The fixed assets, specially machinery and equipment, can be acquired either on cash basis (instant payment) or on installments or leasing basis. Apparently, a firm which acquires such assets on cash basis needs larger amount of fixed capital as compared to the firm which decides to acquire it on installment or lease basis.

17.3.3 Working Capital

Working capital represents the amount of funds invested in current assets like debtors, stock-in-trade and cash required for meeting day-to-day expenses, paying wages/ salaries to its work-force and clearing dues of its creditors. It is also known as **circulating capital** because most of the amount invested in current assets is continuously recovered through realisations of debtors and cash sale of goods, and is re-invested in current assets. It keeps on revolving from cash to current assets and back again to cash as shown in the working capital cycle here.



Working Capital Cycle

It should be noted that a part of working capital is of a permanent nature because depending on the volume of business certain amount of cash, debtors and stock-in-trade shall always be maintained by every firm. This part of working capital is known as **permanent or fixed working capital** and must always be financed through long-term sources. The remaining part of the working capital requirement varies from period to period on account of fluctuations in the volume of business and is called **fluctuating or variable working** capital. This part of working capital is usually financed through short-term sources like bank overdraft, trade creditors, bills payable, etc.

17.3.4 Factors Determing Working Capital Requirement

Adequate working capital is very necessary for maintenance of liquidity and running the business smoothly and efficiently. However, the amount of working capital required varies from business to business and from period to period. The various factors that influence such requirement are as follows:

(a) **Nature of Business :** The working capital requirement of the manufacturing companies is usually high as they require huge stock-in-trade (inventories) and the amount of their debtors is also expected to be large because of the credit sales involved. As against this, the public utilities like electricity and telephone companies

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and the concerns like hotels, restaurants, etc. can manage with small amount of working capital as most of their transactions are undertaken on cash basis and their inventory needs are low.

(b) **Size of Business :** The size or volume of business plays a major role in determining the amount of working capital requirement of every firm. Obviously, larger the volume of business, larger would be the amount of working capital need. This is because, as their inventory requirement will be large and so also the amount of their debtors.

(c) **Length of Production Cycle :** Length of production cycle refers to the time period involved in converting raw-material into finished goods. Longer the length of such period, larger will be the requirement of working capital and vice versa. The length of production cycle, however, depends upon the type of product being manufactured and the nature of technology used. For example, in case of products like cars and cotton textiles, the production cycle is much longer than in case of items like stationery, detergents, etc. Therefore working capital requirement is large for car companies and textile mills. Similarly, the firms using updated technology may have shorter production cycles and hence their requirement of working capital may not be large.

(d) **Inventory Turnover Rate :** Inventory turnover rate refers to the speed at, or the time period within which finished stock is converted into sales. There is a high degree of correlation between the amount of working capital required and the inventory turnover rate. A firm having high inventory turnover rate needs less working capital as against a firm which has low inventory turnover rate. It is so because the firm with high rate can manage with less investment in stock. Take the case of a retailer dealing in fast moving items like groceries and cosmetics with a high turnover rate. Its investment in stock is bound to be much less than a retailer who is dealing in slow moving items like readymade garments or electronics goods.

(e) **Credit Policy :** The firms which provide liberal credit facility to their customers need more working capital as compared to those firms which observe strict credit terms and are efficient in realisation of their debts. It is so because when customers enjoy longer period of credit, a larger amount of firm's funds get tied up with debtors. This results in higher requirement of working capital. However, if such a firm also enjoys liberal credit facility from its suppliers, it can manage with lower amount of working capital. But, this may not be true in all cases.

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(f) Seasonal Fluctuations : The firms that are engaged in manufacturing products like ceiling fans or woollen garments, the demand of which is limited to a specific period of the year, require higher amount of working capital not only during the peak period but also during off season. This is so because they may be left with a good amount of unsold goods which is kept in stock for sale during the next season.

There is no denying the fact that the firms dealing in consumer durables or items involving long production period or wide seasonal fluctuations require large amount of working capital. But, with proper planning and efficient management of inventories and debt collection exercise, the firms can drastically reduce their working capital requirement.

INTEXT QUESTIONS 17.3

1. Mention any two factors that determine Fixed Capital requirement.
2. State whether we require 'more' or 'less' working capital in the following cases:
   - (a) A company manufacturing Iron & steel.
   - (b) A bread manufacturing company having high inventory turnover.
   - (c) A large size business enterprise making toys.
   - (d) A company manufacturing furnitures against orders only.
   - (e) A company manufacturing of coolers/refrigerators.
3. Match the items in column A with column B.

(a)	Fixed capital	(i)	Short term finance
(b)	Public utilities	(ii)	Working capital requirement
(c)	Permanent working capital	(iii)	Long-term finance
(d)	Goodwill	(iv)	Telephone company
(e)	Fluctuating working capital	(v)	Intangible fixed asset
(f)	Length of production cycle	(vi)	Fixed working capital

17.4 CAPITAL STRUCTURE

The financial requirement of a firm can be met through **ownership** capital and/or **borrowed** capital. The **ownership** capital refers to the amount of capital contributed by the owners. In case of a company, it refers to the amount of funds raised by issuing shares. The main characteristic of the ownership capital is that its contributors are

entitled to get dividend out of earnings after the payment of interest and taxes. Hence, the rate of return on such capital depends upon the level of profits earned, and, if there are no profits, no dividend may be paid.

Borrowed capital, on the other hand, refers to the amount of funds raised through long term loans and debentures on which its contributors are entitled to a fixed rate of interest which has to be paid at regular intervals (half-yearly or yearly) irrespective of the profits earned. There is also a commitment that the principal amount shall be repaid on maturity. However, it is still considered advantageous to finance business activities through borrowed capital because if the rate of earnings from the planned business investment is expected to be better than the rate of interest on the borrowed funds, it shall ensure higher returns on owners' funds. Let us take an example and understand this concept more clearly.

Capital Structure

	Illustration - 'A' Total Capital Rs. 50 lakh (Rs. 20 lakh owners fund + Rs. 30 lakh borrowed fund)	*Illustration - 'B' Total Capital Rs. 50 lakh (Rs. 50 lakh owners fund + no borrowed fund)*
Earnings before interest and tax (EBIT)	10,00,000	10,00,000
Less : Interest @ 10% on borrowed fund	3,00,000	—
Profit/Earnings after interest but before tax	7,00,000	10,00,000
Less : Tax on profit @ 40%	2,80,000	4,00,000
Profit after tax (PAT)	4,20,000	6,00,000
Return on owners' funds $\left(\frac{\text{PAT}}{\text{Owners'funds}} \times 100\right)$	$\frac{4,20,000}{20,00,000} \times 100 = 21\%$	$\frac{6,00,000}{50,00,000} \times 100 = 12\%$

Suppose the total investment in a business is Rs. 50 lakh, to which owners contribute Rs.20 lakh and the remaining amount of Rs.30 lakh is funded through loans at 10% interest per annum. Assuming expected annual earnings before interest and tax are Rs. 10 lakh (20% on total investment) the profit after payment of interest but before tax will be Rs.7 lakh (Rs.10 lakh –Rs.3 lakh). Let us assume that the tax is payable on profits at the rate of 40%, the profit after tax will be Rs.4.20 lakh (Rs.7 lakh-Rs.2.80 lakh tax) and the return on owners' funds will be 21% . Now, suppose the whole amount of required investment of Rs.50 lakh is contributed by the owners and no loan is taken. Since no interest is payable, the amount of tax will be Rs.4 lakh (40% on Rs.10 lakh) and the profit after tax Rs.6 lakh (Rs.10 lakh – Rs.4 lakh tax). This shall result in 12% return on owner's funds. Thus, you observe that owners get higher return when a part of capital required is funded by borrowings. This is called **'Trading on Equity or Leverage Effect'**. But, there is also an element of risk in using borrowed funds because when the profits decline, interest being a fixed charge, the return on owners' funds is likely to decline. This implies that dependence on borrowings should be kept within reasonable limits. Therefore, most companies generally plan to raise the required amount of long-term funds by using a judicious mix of ownership capital (called equity) and borrowed capital (called debt). **The mix of equity and debt actually used by a company for meeting its requirement of capital is known as its capital structure.** Thus, the term capital structure refers to the make up of a firm's capital in terms of the planned mix of different kinds of long-term funds like equity shares, preference shares, debentures and long term funds. So capital structure involves two basic decisions :

(a) The type of securities to be issued or raised; and

(b) The relative proportion of each type of security.

17.4.1 Factors Determining the Capital Structure

You have learnt that the mix of debt and equity used (called the capital structure) for meeting the capital requirements of a company affects the rate of return on owners' capital (shareholders' funds). This in turn, determines the earnings per equity share (EPS) and has its effect on the market value of company's shares. Hence, the choice of an appropriate capital structure becomes a very important decision for the finance manager of any company. He should make this decision on the basis of reliable data and after careful analysis of all the factors that influence this choice. Following are the factors that should be kept in view while deciding on the choice of an appropriate capital structure.

1. **Expected earnings and their stability :** If the expected earnings, in terms of rate of return on the amount to be invested are sufficiently large, use of debt is considered quite desirable. Not only that, the stability of earnings should also be taken into account because if the firm is engaged is business activities in which sales and profits are subject to wide fluctuations, it will be risky to use higher proportion of debt. In other words, if there is an element of uncertainty about the expected earnings it is considered better to rely more on equity share capital. However, with assured prospects of rising earnings, there should be greater reliance on debt so as to take advantage of leverage effect.

2. **Cost of debt :** If the rate of interest on borrowings is lower than the expected rate of return on capital employed, then debt may be preferred. With lower cost of debt financing, the overall cost of financing is reduced and the return on equity capital will be higher, as explained earlier.

3. **Right to manage the business :** You know that the debentureholders and preference shareholders do not have much say in management of the company. This authority lies primarily with the equity shareholders who have the voting rights. Hence, while deciding on the mix of equity and debt, the promoters/existing management of the company may also take into account the possible effect of raising funds through equity shares on the right to control the business. In order to retain their right to control the affairs of the company, they may prefer to raise additional funds mainly through debentures and preference shares.

4. **Capital market conditions :** The conditions in the capital market also influence the capital structure decision. At times capital market is so depressed that the investors are unwilling to subscribe to shares. In such a situation, it is considered better to rely on debt or defer the decision till a favourable market condition is restored.

5. **Regulatory norms :** While deciding on the capital structure, the legal constraints like the limit on debt-equity ratio should also be kept in view. At present, such limit is 2:1 in most cases. This implies that at any point of time, the debt should not be more than twice the amount of share capital. This limit keeps on changing with changing economic environment and varies from industry to industry.

6. **Flexibility :** The planned capital structure should be flexible enough to raise additional funds without much difficulty. The company should be able to raise additional capital in the form of debt or equity whenever required. But if the company's capital structure has too much debt, then the lenders may not be able to give more loan to the company. In a such a situation it may be forced to raise the funds only through shares for which the capital market condition may not be conducive. Similarly, when on account of declining business and lack of other investment opportunities the funds need to be refunded, it may not be possible to do so if the company has heavily relied on equity shares which cannot be redeemed easily. Hence, to ensure an element of flexibility, it is better if the firm relies more on redeemable securities that can be paid off if necessary and, at the same time, have some unused debt raising capacity so that future financial needs can be fully taken care of without much difficulty.

7. **Investors' attitude towards investment :** While planning the capital structure of a company one must bear in mind that all investors do not have the same attitude towards their investment. Some are highly conservative who prefer safety

to return. For such investors, debentures are considered most suitable. As against this, there are some who are interested in high return on their investments and are ready to take the risk involved. Such investors prefer equity shares. Then, there are many who are willing to take a limited risk provided the return is better than the rate on secured debentures and bonds. Preference shares are most suitable for this category of investors. In order to attract all categories of investors, it is considered more desirable to issue different types of securities specially when the amount of capital requirement is large.

Looking at the above considerations, it can be safely concluded that an appropriate capital structure is one which:

(a) ensures maximum return on equity by making use of the leverage effect within reasonable limits of the risk involved;

(b) caters to all types of investors by using a judicious mix of different types of securities;

(c) has the necessary flexibility to make required reduction or addition to funds, according to changed conditions;

(d) involves minimum risk of dilution in control of the company affairs by the existing group of shareholders; and

(e) fully keeps in view the legal constraints and the prevailing capital market conditions.

To sum up, the most judicious capital structure is one that minimises the cost of funds and maximises the shareholders wealth. In financial management terminology, such a capital structure is called **optimal capital structure**.

INTEXT QUESTIONS 17.4

1. Why do you need flexibility in capital structure?

2. Which of the following are characteristics of an appropriate capital structure? Indicate, by writing YES or NO in the space provided. Rewrite the statements where your answers is NO.

   (a) It involves a judicious mix of different types of securities.

   (b) It involves dilution of control of existing shareholders.

   (c) It caters to exclusively to the wealthy investors.

   (d) It ensures minimum return on equity.

   (e) It keeps in view the legal constraints.

   (f) It has rigidity and firmness and does not change with changed conditions.

17.5 DIVIDEND

You know that in every business unit the amount of profit earned (or loss incurred) during a financial year is ascertained and distributed among its owners. In case of a proprietary concern, the whole amount of profit or loss so ascertained is added to proprietor's capital and whatever amount is withdrawn by him is termed as drawings and is deducted from his capital. Similarly, incase of a partnership firm the profit or loss is distributed among the partners in their agreed profit sharing ratio and included in their capital. Whatever amount is withdrawn by the partners is deducted from their respective capitals as drawings. In case of a company, however, it is dealt with differently. First of all we work out the operating profits (called PBIT – Profit before interest and tax). Then deduct the amount of interest on loans therefrom and arrive at the amount of profits before tax (PBT). Then we deduct the amount of tax on the company's profits as per rules and ascertain the profit after tax (PAT). This is the amount of profit which is available for distribution among the shareholders. As a matter of practice and financial prudence, the whole amount of profit earned by the company is never distributed to the shareholders. A substantial part of it, is retained for meeting company's future financial needs. The amount of profits so retained is called **'retained earnings'** and the amount profit distributed to the shareholders is called as **'dividend'**. It may be noted that the dividend paid to preference shareholders is called 'preference dividend' and the dividend paid to equity shareholders is called 'equity dividend'.

17.5.1 Factors Affecting Dividend Decisions

The dividend to preference shareholders is paid at fixed rate and paid on priority basis i.e., before making payment to equity shareholders. The dividend to be paid to equity shareholders is the real issue involved in dividend decision by the management of any company. Such a decision is guided by the following factors:

1. **Financial needs of the company :** While deciding the amount of dividend to be paid, the management must take into account the financial needs for normal growth of its business, the expansion activities, the repayment of long term debt, etc. Even otherwise, the company must retain a part of profits for long term solvency and meeting future contingencies.

2. **Liquidity requirement :** The payment of dividend involves out flow of cash. At times, a company may have high profits but not much cash. In such a situation, it may not declare high rate of dividend. Even otherwise, liquidity requirement for ensuring timely payment of all dues and debts has to be kept in view while determining the rate of dividend. Such a consideration is of greater importance in case of a growing concern whose liquidity needs may be large on account of its expansion activities and growing working capital requirement, and therefore, they would prefer low payout.

Notes

3. **Access to capital market :** A company which, by virtue of its record of profitability and timely repayment of debt, has better access to capital market i.e., it can successfully raise funds by issuing shares and debentures through the capital market, may pay higher dividends. But, if a company does not have easy access to capital markets because of its weak financial position or low profitability record, it cannot afford to pay high dividends. However, when capital market condition is unfavourable most companies shall adopt a conservative dividend policy.

4. **Expectations of shareholders :** The equity shareholders normally look forward to appreciation to their capital rather than higher rate of dividend. But, some shareholders like retired persons or employees do look forward to dividend as a source of their regular income. So, the companies cannot ignore such segment and pay low dividend or skip it even when there are high profits. A reasonable payout is always welcome. In fact, the companies which skip payment of dividend or pay too low rate of dividend as a matter of practice, are rated low in the capital market as the shareholders suspect their management's intentions.

5. **Tax policy :** In our country, dividends have been taxable in the hands of shareholders. Hence, the companies prefer to pay low amount of dividend and issue bonus shares to the shareholders from time to time as these are not taxable until these are sold. If these are sold after 12 months, the sale proceeds are regarded as long term capital gain and taxed at a lower rate. However, of late, the government has changed its policy of taxation of dividends. The dividends are not taxable in the hands of shareholders. But the company has to pay some additional tax (12.5%) on the distributed part of its profits. So, the companies have now become liberal in the matter of dividend distribution.

6. **Investment opportunities and growth prospects :** When a company has adequate profitable investment opportunities and growth prospects, it may prefer to retain more profits and pay low rate of dividends so as to serve the shareholders in a better way in long run. Of course, in the absence of such possibilities, companies prefer payment of higher dividend and avoid idle cash with them.

7. **Legal constraints :** Sometimes, the government prescribes certain limits on the dividend payout which has to be kept in view while deciding on the rate of dividend to be paid. Similarly, at times the long term fund providers may put some restrictions on the dividend payout as part of their agreement. The companies have to adhere to such limits. In any case, the Company Law has provided certain rules to be followed while deciding on the amount to be distributed as dividend. For example, capital profits are not to be used for distribution of dividend normally; a banking company has to transfer certain percentage of profit to a statutory reserve which is not available for payment of dividend, and so on. These have to be duly abided while determining the amount to be distributed as dividend.

INTEXT QUESTIONS 17.5

1. Give the full form of the following abbreviations.

   (a) PAT (b) PBT (c) PBIT

2. List any five factors affecting the dividend decision of a company.

3. State the meaning of the following terms in the space provided.

   (a) Dividend

   (b) Retained Earnings

   (c) Preference Dividend

   (d) Equity Dividend

WHAT YOU HAVE LEARNT

- Adequate and proper financing is quite important for success in any business. While the overall managerial activity of handling finance is called 'Financial management', the process of estimating the financial requirement, determining the pattern of financing and formulating financial policies and procedures is termed as 'Financial planning'. To achieve the objectives of financial planning effectively, it must be ensured that the financial plan is simple, takes a long-term view, has the necessary flexibility to meet changing financial needs of the organisation, provides for reasonable amount at the lowest possible cost, and takes care of the liquidity requirement of the company.

- The firm's capital requirement can be broadly divided into fixed capital and working capital requirements. Fixed capital represents the requirement of capital for permanent or long-term financial needs of the business. Such requirement depends upon the nature of business, size of business, product involved, type of production process adopted, method of acquiring the fixed assets such as cash basis, installment payment method or lease basis. Fixed capital is funded through long-term sources of finance.

- Working capital represents the amount of funds required for financing current assets. A part of the working capital requirement is of a permanent/fixed nature which has to be funded through long-term sources. But the major part of working capital is fluctuating in nature which varies with fluctuations in the volume of business from time to time and is funded through short term sources like bank overdraft, suppliers' credit, etc. The working capital requirement is determined by the nature of business, size of business, length of production cycle, inventory turnover rate, firm's credit policy for its customers and seasonal fluctuations.

- The main objective of financial management is to maximise the wealth of shareholders.
- Investment decision is concerned with careful selections of assets in which funds will be invested by the firm.
- Financial decision specify the ratio of owned funds and borrowed funds.
- Dividend decision decide how much profits to be distributed as dividend and how much to retain for expansion activities.
- Financial planning is helpful in avoiding problem of shortage and surplus of funds, effective utilisation of funds, coordination and control of funds.
- Financial planning decides how much to spend and on what to spend.
- Financial planning is helpful in developing a sound capital structure, estimating accurate requirement of fund, effective utilisation of fund, in avoiding shortage of funds and surplus of funds, provides policies for different departments and control financial activities.
- The financial requirement of a firm can be met through ownership capital (equity) and/or borrowed capital (debt). The firms normally use a judicious mix of debt and equity in order to ensure a higher return on owners' funds. Such a mix is termed as the 'Capital structure' of the firm. The choice of an appropriate capital structure is determined by a host of factors. They are: (1) expected earnings and their stability, (2) cost of debt, (3) effect on right to control, (4) capital market, (5) regulatory norms, (6) flexibility, and (7) investors' attitude towards investment.
- Dividend refers to the amount of profits distributed by a company to its shareholders. The amount of profit to be distributed as dividend and the amount of profit to be retained by the company for meeting its future financial requirement is determined by factors like future financial needs of the company, liquidity requirement, company's access to capital market, expectations of the shareholders, tax policy, investment opportunity and growth prospects and legal constraints, if any.

KEY TERMS

Capital structure | Fixed capital | DividendFinancial mix | Retained earning

Trading on equity | Working capital cycle | Working capital

Notes

TERMINAL EXERCISE

Very Short Answer Type Questions

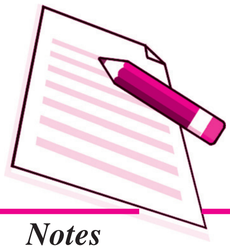
1. Define the term 'Dividend'.
2. What is meant by 'Optimal Capital Structure'?
3. State the meaning of Financial Management.
4. What is meant by Financial Planning?

Short Answer Type Questions

5. State any four objectives of financial planning.
6. Explain any two factors that are taken into consideration while determining the fixed capital requirement of a company.
7. Do you advocate distribution of whole amount of profits earned by a company as dividends? Support your view with reasons.
8. Describe any two determinants of capital structure.
9. What is meant by 'Trading on Equity'?
10. Briefly describe the objectives of Financial Management.
11. What do you mean by Investment Decision?

Long Answer Type Questions

12. What is meant by 'Financial Planning' ? Explain any four requisites of a sound financial plan.
13. How does raising of long term funds through debt affect the return on shareholders' funds? Explain with an example.
14. What is meant by 'dividend'? State the factors that affect dividend decision.
15. How do you assess the amount of working capital required by a business unit? Describe in brief.
16. Explain the decisions involved in financial management.
17. Explain briefly the importance of financial planning.



Notes

ANSWERS TO INTEXT QUESTIONS

17.1 1. (a) 2. (c) 3. (a)

17.2 2. (c) and (e)

3. (a) Yes (b) No (c) Yes (d) No (e) Yes

17.3 2. (a) More (b) Less (c) More (d) Less (e) More

3. (a) (iii) (b) (iv) (c) (vi) (d) (v) (e) (i) (f) (ii)

17.4 2. (a) Yes

(b) No – It involves minimum risk of dilution in control by existing shareholders.

(c) No – It caters to all types of investors

(d) No – It ensures maximum return on equity

(e) Yes

(f) No – It has the necessary flexibility to make required reduction or addition to funds, according to changed conditions.

17.4 1. (a) Profit After Tax (b) Profits Before Tax

(c) Profit Before Interest and Tax

2. (a) Financial needs of the company (b) Liquidity

(c) Access to capital market (d) Tax policy

(e) Legal constraints

3. (a) Amount of profit distributed to shareholders.

(b) The part of profit retained in the company to meet the company's future financial needs.

(c) Dividend paid to preference shareholders.

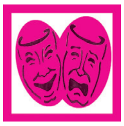
(d) Dividend paid to equity shareholders.

DO AND LEARN

Pick up any 10 items/products that you see/use, for example, sugar, furniture, cooler etc. List them and analyse whether each of them require huge or less working capital for production and why?

S. No.	*Product*	*More/Less Working Capital*	*Reasons*
1.			
2.			

3.			
4.			
5.			
6.			
7.			
8.			
9.			
10.			



ROLE PLAY

Mr. K. Gandhi was the director of Alter Ltd. He was very upset when the finance manager Mr. R. Khanna presented the financial report of the company before him.

Mr. Gandhi : What is this Mr. Khanna?

Mr. Khanna : Sir, to be honest, this is the real position of the firm. Our firm as of today is over-capitalised.

Mr. Gandhi : When we started this company four years back it was having normal/proper capitalisation.

Mr. Khanna : May be sir, but it is not so now?

Mr. Gandhi : What makes you say that?

Mr. Khanna : Sir, in the first place our returns on investment is not justified.

Mr. Gandhi : What do you mean by that?

Mr. Khanna : Sir, the other firms in the industry are earning average return of 10% and ours is only 8%.

Mr. Gandhi : What else?

Mr. Khanna and Mr. Gandhi discussed the causes, effects and remedies of over-capitalisation.

You are required to continue the above conversation by assuming a role for yourself and one for your friend.

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18

INDIAN FINANCIAL MARKET

You are fully aware that business units have to raise short-term as well as long-term funds to meet their working and fixed capital requirements from time to time. This necessitates not only the ready availability of such funds but also a transmission mechanism with the help of which the providers of funds (investors/ lenders) can interact with the borrowers/users (business units) and transfer the funds to them as and when required. This aspect is taken care of by the financial markets which provide a place where or a system through which, the transfer of funds by investors/lenders to the business units is adequately facilitated.

OBJECTIVES

After studying this lesson, you will be able to:

- explain the concept and functions of financial markets;
- state the nature and importance of money market;
- state the nature and types of capital market;
- distinguish between capital market and money market;
- explain the nature and functions of a stock exchange;
- state the advantages of stock exchanges from the points of view of companies, investors and society as a whole;
- state the limitations of stock exchanges;
- explain the concept of speculation and distinguish it from investment;
- outline the stock exchanges in India; and
- describe the nature of regulation of stock exchanges in India and the role of SEBI.


Notes

18.1 FINANCIAL MARKET

We know that, money always flows from surplus sector to deficit sector. That means persons having excess of money lend it to those who need money to fulfill their requirement. Similarly, in business sectors the surplus money flows from the investors or lenders to the businessmen for the purpose of production or sale of goods and services. So, we find two different groups, one who invest money or lend money and the others, who borrow or use the money.

Now you think, how these two groups meet and transact with each other. The financial markets act as a link between these two different groups. It facilitates this function by acting as an intermediary between the borrowers and lenders of money. So, financial market may be defined as 'a transmission mechanism between investors (or lenders) and the borrowers (or users) through which transfer of funds is facilitated'. It consists of individual investors, financial institutions and other intermediaries who are linked by a formal trading rules and communication network for trading the various financial assets and credit instruments.

Before reading further let us have an idea about some of the credit instruments.

A **bill of exchange** is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to or to the order of a certain person, or to the bearer of the instrument. To clarify the meaning let us take an example. Suppose Gopal has given a loan of Rs. 50,000 to Madan, which Madan has to return. Now, Gopal also has to give some money to Madhu. In this case, Gopal can make a document directing Madan to make payment up to Rs. 50,000 to Madhu on demand or after expiry of a specified period. This document is called a bill of exchange, which can be transferred to some other person's name by Madhu.

A **promissory note** is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument. Suppose you take a loan of Rs. 20,000 from your friend Jagan. You can make a document stating that you will pay the money to Jagan or the bearer on demand. Or you can mention in the document that you will pay the amount after three months. This document, once signed by you, duly stamped and handed over to Jagan, becomes a negotiable instrument. Now Jagan can personally present it before you for payment or give this document to some other person to collect money on his behalf. He can endorse it in somebody else's name who in turn can endorse it further till the final payment is made by you to whosoever presents it before you. This type of a document is called a Promissory Note.

Let us now see the main functions of financial market.

Notes

(a) It provides facilities for interaction between the investors and the borrowers.

(b) It provides pricing information resulting from the interaction between buyers and sellers in the market when they trade the financial assets.

(c) It provides security to dealings in financial assets.

(d) It ensures liquidity by providing a mechanism for an investor to sell the financial assets.

(e) It ensures low cost of transactions and information.

18.2 TYPES OF FINANCIAL MARKETS

A financial market consists of two major segments: (a) Money Market; and (b) Capital Market. While the money market deals in short-term credit, the capital market handles the medium term and long-term credit.

Let us discuss these two types of markets in detail.

18.3 MONEY MARKET

The money market is a market for short-term funds, which deals in financial assets whose period of maturity is upto one year. It should be noted that money market does not deal in cash or money as such but simply provides a market for credit instruments such as bills of exchange, promissory notes, commercial paper, treasury bills, etc. These financial instruments are close substitute of money. These instruments help the business units, other organisations and the Government to borrow the funds to meet their short-term requirement.

Money market does not imply to any specific market place. Rather it refers to the whole networks of financial institutions dealing in short-term funds, which provides an outlet to lenders and a source of supply for such funds to borrowers. Most of the money market transactions take place on telephone, fax or Internet. The Indian money market consists of Reserve Bank of India, Commercial banks, Co-operative banks, and other specialised financial institutions. The Reserve Bank of India is the leader of the money market in India. Some Non-Banking Financial Companies (NBFCs) and financial institutions like LIC, GIC, UTI, etc. also operate in the Indian money market.

18.3.1 Money Market Instruments

Following are some of the important money market instruments or securities.

(a) Call Money : Call money is mainly used by the banks to meet their temporary requirement of cash. They borrow and lend money from each other normally on a daily basis. It is repayable on demand and its maturity period varies between one day to a fortnight. The rate of interest paid on call money loan is known as call rate.

(b) **Treasury Bill :** A treasury bill is a promissory note issued by the RBI to meet the short-term requirement of funds. Treasury bills are highly liquid instruments, that means, at any time the holder of treasury bills can transfer or get it discounted from RBI. These bills are normally issued at a price less than their face value; and redeemed at face value. So the difference between the issue price and the face value of the treasury bill represents the interest on the investment. These bills are secured instruments and are issued for a period of not exceeding 364 days. Banks, Financial institutions and corporations normally play major role in the Treasury Bill market.

(c) **Commercial Paper :** Commercial paper (CP) is a popular instrument for financing working capital requirements of companies. The CP is an unsecured instrument issued in the form of promissory note. This instrument was introduced in 1990 to enable the corporate borrowers to raise short-term funds. It can be issued for period ranging from 15 days to one year. Commercial papers are transferable by endorsement and delivery. The highly reputed companies (Blue Chip companies) are the major player of commercial paper market.

(d) **Certificate of Deposit :** Certificate of Deposit (CDs) are short-term instruments issued by Commercial Banks and Special Financial Institutions (SFIs), which are freely transferable from one party to another. The maturity period of CDs ranges from 91 days to one year. These can be issued to individuals, co-operatives and companies.

(e) **Trade Bill :** Normally the traders buy goods from the wholesalers or manufactures on credit. The sellers get payment after the end of the credit period. But if any seller does not want to wait or in immediate need of money he/she can draw a bill of exchange in favour of the buyer. When buyer accepts the bill it becomes a negotiable instrument and is termed as bill of exchange or trade bill. This trade bill can now be discounted with a bank before its maturity. On maturity the bank gets the payment from the drawee i.e., the buyer of goods. When trade bills are accepted by Commercial Banks it is known as Commercial Bills. So trade bill is an instrument, which enables the drawer of the bill to get funds for short period to meet the working capital needs.

18.4 CAPITAL MARKET

Capital Market may be defined as a market dealing in medium and long-term funds. It is an institutional arrangement for borrowing medium and long-term funds and provides facilities for marketing and trading of securities. So it constitutes all long-term borrowings from banks and financial institutions, borrowings from foreign markets and raising of capital by issue various securities such as shares debentures, bonds, etc. In the present chapter let us discuss about the market for trading of securities.

Notes

The market where securities are traded is known as Securities market. It consists of two different segments namely primary and secondary market. The primary market deals with new or fresh issue of securities and is, therefore, also known as **new issue market**; whereas the secondary market provides a place for purchase and sale of existing securities and is often termed as **stock market** or **stock exchange**.

18.4.1 Primary Market

The Primary Market consists of arrangements, which facilitate the procurement of long-term funds by companies by making fresh issue of shares and debentures. You know that companies make fresh issue of shares and/or debentures at their formation stage and, if necessary, subsequently for the expansion of business. It is usually done through private placement to friends, relatives and financial institutions or by making public issue. In any case, the companies have to follow a well-established legal procedure and involve a number of intermediaries such as underwriters, brokers, etc. who form an integral part of the primary market. You must have learnt about many initial public offers (IPOs) made recently by a number of public sector undertakings such as ONGC, GAIL, NTPC and the private sector companies like Tata Consultancy Services (TCS), Biocon, Jet-Airways and so on.

18.4.2 Secondary Market

The secondary market known as stock market or stock exchange plays an equally important role in mobilising long-term funds by providing the necessary liquidity to holdings in shares and debentures. It provides a place where these securities can be encashed without any difficulty and delay. It is an organised market where shares, and debentures are traded regularly with high degree of transparency and security. In fact, an active secondary market facilitates the growth of primary market as the investors in the primary market are assured of a continuous market for liquidity of their holdings. The major players in the primary market are merchant bankers, mutual funds, financial institutions, and the individual investors; and in the secondary market you have all these and the stockbrokers who are members of the stock exchange who facilitate the trading.

After having a brief idea about the primary market and secondary market let see the difference between them.

18.5 DISTINCTION BETWEEN PRIMARY MARKET AND SECONDARY MARKET

The main points of distinction between the primary market and secondary market are as follows:

1. **Function :** While the main function of primary market is to raise long-term funds through fresh issue of securities, the main function of secondary market is to provide continuous and ready market for the existing long-term securities.

2. **Participants :** While the major players in the primary market are financial institutions, mutual funds, underwriters and individual investors, the major players in secondary market are all of these and the stockbrokers who are members of the stock exchange.

3. **Listing Requirement :** While only those securities can be dealt within the secondary market, which have been approved for the purpose (listed), there is no such requirement in case of primary market.

4. **Determination of prices :** In case of primary market, the prices are determined by the management with due compliance with SEBI requirement for new issue of securities. But in case of secondary market, the price of the securities is determined by forces of demand and supply of the market and keeps on fluctuating.

18.6 DISTINCTION BETWEEN CAPITAL MARKET AND MONEY MARKET

Capital Market differs from money market in many ways. Firstly, while money market is related to short-term funds, the capital market is related to long term funds. Secondly, while money market deals in securities like treasury bills, commercial paper, trade bills, deposit certificates, etc., the capital market deals in shares, debentures, bonds and government securities. Thirdly, while the participants in money market are Reserve Bank of India, commercial banks, non-banking financial companies, etc., the participants in capital market are stockbrokers, underwriters, mutual funds, financial institutions, and individual investors. Fourthly, while the money market is regulated by Reserve Bank of India, the capital market is regulated by Securities Exchange Board of India (SEBI).

INTEXT QUESTIONS 18.1

1. Define financial market.

2. Complete the table given below.

   (a) Distinction between Primary Market and Secondary Market.

Points of Difference	Primary Market	Secondary Market
1. Function	(i)	To provide continuous and ready market for existing long-term securities.
2. Participants	Financial Institutions, mutual funds, underwriters and individual investors.	(ii)

Notes

3. Listing Requirement	Listing is not required for dealing in the primary market.	(iii)
4. Determination of Prices	(iv)	Prices are determined by forces of demand and supply and keep on fluctuating.

(b) Differentiate between Money Market and Capital Market.

Point of Distinction	Money Market	Capital Market
1. Time period / Term		
2. Instrument dealt in		
3. Participants		
4. Regulatory body		

18.7 STOCK EXCHANGE

As indicated above, stock exchange is the term commonly used for a secondary market, which provide a place where different types of existing securities such as shares, debentures and bonds, government securities can be bought and sold on a regular basis. A stock exchange is generally organised as an association, a society or a company with a limited number of members. It is open only to these members who act as brokers for the buyers and sellers. The Securities Contract (Regulation) Act has defined stock exchange as an "association, organisation or body of individuals, whether incorporated or not, established for the purpose of assisting, regulating and controlling business of buying, selling and dealing in securities".

The main characteristics of a stock exchange are:

1. It is an organised market.
2. It provides a place where existing and approved securities can be bought and sold easily.
3. In a stock exchange, transactions take place between its members or their authorised agents.
4. All transactions are regulated by rules and by laws of the concerned stock exchange.
5. It makes complete information available to public in regard to prices and volume of transactions taking place every day.

Notes

It may be noted that all securities are not permitted to be traded on a recognised stock exchange. It is allowed only in those securities (called listed securities) that have been duly approved for the purpose by the stock exchange authorities. The method of trading now-a-days, however, is quite simple on account of the availability of on-line trading facility with the help of computers. It is also quite fast as it takes just a few minutes to strike a deal through the brokers who may be available close by. Similarly, on account of the system of scrip-less trading and rolling settlement, the delivery of securities and the payment of amount involved also take very little time, say, 2 days.

18.7.1 Functions of a Stock Exchange

The functions of stock exchange can be enumerated as follows:

1. **Provides ready and continuous market :** By providing a place where listed securities can be bought and sold regularly and conveniently, a stock exchange ensures a ready and continuous market for various shares, debentures, bonds and government securities. This lends a high degree of liquidity to holdings in these securities as the investor can encash their holdings as and when they want.

2. **Provides information about prices and sales :** A stock exchange maintains complete record of all transactions taking place in different securities every day and supplies regular information on their prices and sales volumes to press and other media. In fact, now-a-days, you can get information about minute to minute movement in prices of selected shares on TV channels like CNBC, Zee News, NDTV and Headlines Today. This enables the investors in taking quick decisions on purchase and sale of securities in which they are interested. Not only that, such information helps them in ascertaining the trend in prices and the worth of their holdings. This enables them to seek bank loans, if required.

3. **Provides safety to dealings and investment :** Transactions on the stock exchange are conducted only amongst its members with adequate transparency and in strict conformity to its rules and regulations which include the procedure and timings of delivery and payment to be followed. This provides a high degree of safety to dealings at the stock exchange. There is little risk of loss on account of non-payment or non-delivery. Securities and Exchange Board of India (SEBI) also regulates the business in stock exchanges in India and the working of the stock brokers.

   Not only that, a stock exchange allows trading only in securities that have been listed with it; and for listing any security, it satisfies itself about the genuineness and soundness of the company and provides for disclosure of certain information on regular basis. Though this may not guarantee the soundness and profitability of the company, it does provide some assurance on their genuineness and enables them to keep track of their progress.

4. **Helps in mobilisation of savings and capital formation :** Efficient functioning of stock market creates a conducive climate for an active and growing primary market. Good performance and outlook for shares in the stock exchanges imparts buoyancy to the new issue market, which helps in mobilising savings for investment in industrial and commercial establishments. Not only that, the stock exchanges provide liquidity and profitability to dealings and investments in shares and debentures. It also educates people on where and how to invest their savings to get a fair return. This encourages the habit of saving, investment and risk-taking among the common people. Thus, it helps mobilising surplus savings for investment in corporate and government securities and contributes to capital formation.

5. **Barometer of economic and business conditions :** Stock exchanges reflect the changing conditions of economic health of a country, as the shares prices are highly sensitive to changing economic, social and political conditions. It is observed that during the periods of economic prosperity, the share prices tend to rise. Conversely, prices tend to fall when there is economic stagnation and the business activities slow down as a result of depressions. Thus, the intensity of trading at stock exchanges and the corresponding rise on fall in the prices of securities reflects the investors' assessment of the economic and business conditions in a country, and acts as the barometer which indicates the general conditions of the atmosphere of business.

6. **Better Allocation of funds :** As a result of stock market transactions, funds flow from the less profitable to more profitable enterprises and they avail of the greater potential for growth. Financial resources of the economy are thus, better allocated.

18.7.2 Advantages of Stock Exchanges

Having discussed the functions of stock exchanges, let us look at the advantages which can be outlined from the point of view of (a) Companies, (b) Investors, and (c) the Society as a whole.

(a) To the Companies

(i) The companies whose securities have been listed on a stock exchange enjoy a better goodwill and credit-standing than other companies because they are supposed to be financially sound.

(ii) The market for their securities is enlarged as the investors all over the world become aware of such securities and have an opportunity to invest

(iii) As a result of enhanced goodwill and higher demand, the value of their securities increases and their bargaining power in collective ventures, mergers, etc. is enhanced.

(iv) The companies have the convenience to decide upon the size, price and timing of the issue.

(b) To the Investors

(i) The investors enjoy the ready availability of facility and convenience of buying and selling the securities at will and at an opportune time.

(ii) Because of the assured safety in dealings at the stock exchange the investors are free from any anxiety about the delivery and payment problems.

(iii) Availability of regular information on prices of securities traded at the stock exchanges helps them in deciding on the timing of their purchase and sale.

(iv) It becomes easier for them to raise loans from banks against their holdings in securities traded at the stock exchange because banks prefer them as collateral on account of their liquidity and convenient valuation.

(c) To the Society

(i) The availability of lucrative avenues of investment and the liquidity thereof induces people to save and invest in long-term securities. This leads to increased capital formation in the country.

(ii) The facility for convenient purchase and sale of securities at the stock exchange provides support to new issue market. This helps in promotion and expansion of industrial activity, which in turn contributes, to increase in the rate of industrial growth.

(iii) The Stock exchanges facilitate realisation of financial resources to more profitable and growing industrial units where investors can easily increase their investment substantially.

(iv) The volume of activity at the stock exchanges and the movement of share prices reflect the changing economic health.

(v) Since government securities are also traded at the stock exchanges, the government borrowing is highly facilitated. The bonds issued by governments, electricity boards, municipal corporations and public sector undertakings (PSUs) are found to be on offer quite frequently and are generally successful.

18.7.3 Limitations of Stock Exchanges

Like any other institution, the stock exchanges too have their limitations. One of the common evils associated with stock exchange operations is the excessive speculation. You know that speculation implies buying or selling securities to take advantage of price differential at different times. The speculators generally do not take or give delivery and pay or receive full payment. They settle their transactions just by paying the difference in prices. Normally, speculation is considered a healthy practice and is necessary for successful operation of stock exchange activity. But, when it becomes excessive, it leads to wide fluctuations in prices and various malpractices by the vested interests. In the process, genuine investors suffer and are driven out of the market.

Another shortcoming of stock exchange operations is that security prices may fluctuate due to unpredictable political, social and economic factors as well as on account of rumours spread by interested parties. This makes it difficult to assess the movement of prices in future and build appropriate strategies for investment in securities. However, these days good amount of vigilance is exercised by stock exchange authorities and SEBI to control activities at the stock exchange and ensure their healthy functioning, about which you will study later.

Notes

18.8 SPECULATION IN STOCK EXCHANGES

The buyers and sellers at the stock exchange undertake two types of operations, one for speculation and the other for investment. Those who buy securities primarily to earn a regular income from such investment and possibly make some long-term gain on account of price rise in future are called investors. They take delivery of the securities and make full payment of the price. Such transactions are called investment transactions.

But, when the securities are bought with the sole object of selling them in future at higher prices or these are sold now with the intention of buying at a lower price in future, are called speculation transactions. The main objective of such transactions is to take advantage of price differential at different times. The stock exchange also provides for settlement of such transactions even by receiving or paying, as the case may be, just the difference in prices. For example, Rashmi bought 200 shares of Moser Baer Ltd. at Rs. 210 per share and sold them at Rs. 235 per share. He does not take and give delivery of the shares but settles the transactions by receiving the difference in prices amounting to Rs. 5,000 minus brokerage. In another case, Mohit bought 200 shares of Seshasayee Papers Ltd. at Rs. 87 per share and sold them at Rs. 69 per share. He settles these transactions by simply paying the difference amounting to Rs. 3600 plus brokerage. However, now-a-days stock exchanges have a system of rolling settlement. Such facility is limited only to transactions of purchase and sale made on the same day, as no carry forward is allowed.

Rolling Settlement: Earlier trading in the stock exchange was held face-to-face (called pit-trading) without the use of computers and the advanced computer software as it is today. In those times, transactions were settled (i.e., actual delivery of shares, through share certificates, by the seller and payment of money by the buyer) in the stock exchange, only on a fixed day of the week, say on a Saturday, or a Wednesday irrespective of which day of the week the shares were bought and sold. This was called 'Fixed Settlement'.

Today, with the electronic / computer based system of recording and carrying out of share transactions, stock exchanges go in for 'rolling settlement'. That means, transaction are settled after a fixed number of days of the transaction rather than on a particular day of the week. For example, if a stock exchange goes in for 'T+2' days of rolling settlement, the transaction is settled within two working days of occurring of the transaction, 'T' being the day of the transaction. In T+7' days of rolling settlement, the transaction is settled on the 7th day after the transaction. This is facilitated through electronic transfer of shares, through Dematerialised Account or Demat Account i.e., the share does not have a physical form of a paper document, but is a computerised record of a person holding a share, and through transfer of money electronically or through cheques payment is settled.

Though speculation and investment are different in some respects, in practice it is difficult to say who is a genuine investor and who is a pure speculator. Sometimes even a person who has purchased the shares as a long-term investment may suddenly decide to sell to reap the benefit if the price of the share goes up too high or do it to avoid heavy loss if the prices starts declining steeply. But he cannot be called a speculator because his basic intention has been to invest. It is only when a person's basic intention is to take advantage of a change in prices, and not to invest, then the transaction may be termed as speculation. In strict technical terms, however, the transaction is regarded as speculative only if it is settled by receiving or paying the difference in prices without involving the delivery of securities. It is so because, in practice, it is quite difficult to ascertain the intention.

Some people regard speculation as nothing but gambling and consider it as an evil. But it is not true because while speculation is based on foresight and hard calculation, gambling is a kind of blind and reckless activity involving high degree of chance element. Not only that, speculation is a legal activity duly recognised as a prerequisite for the success of stock exchange operations while gambling is regarded as an evil and a punishable activity. However, reckless speculation may take the form of gambling and should be avoided.

INTEXT QUESTIONS 18.2

1. Enumerate the main characteristics of a stock exchange.

2. Identify which the following statements about stock exchanges are 'True' or 'False'. If the statement is 'False', rewrite it in the correct form.

   (a) Stock Exchange provides a ready market for sale and purchase of gold and silver.

   (b) In the stock exchange, transactions take place between companies and their shareholders directly.

   (c) Stock exchange transactions facilitate flow of funds from less profitable to more profitable enterprises.

(d) It becomes difficult for investors to raise loans from banks against collateral of their holdings in securities traded at the stock exchange.

(e) Speculation is the same thing as gambling.

3. State two limitations of stock exchanges.

18.9 STOCK EXCHANGES IN INDIA

The first organised stock exchange in India was started in Mumbai known as Bombay Stock Exchange (BSE). It was followed by Ahmedabad Stock Exchange in 1894 and Kolkata Stock Exchange in 1908. The number of stock exchanges in India went upto 7 by 1939 and it increased to 21 by 1945 on account of heavy speculation activity during Second World War. A number of unorganised stock exchanges also functioned in the country without any formal set-up and were known as kerb market. The Security Contracts (Regulation) Act was passed in 1956 for recognition and regulation of Stock Exchanges in India. At present we have 23 stock exchanges in the country. Of these, the most prominent stock exchange that came up is National Stock Exchange (NSE). It is also based in Mumbai and was promoted by the leading financial institutions in India. It was incorporated in 1992 and commenced operations in 1994. This stock exchange has a corporate structure, fully automated screen-based trading and nation-wide coverage.

Another stock exchange that needs special mention is Over The Counter Exchange of India (OTCEI). It was also promoted by the financial institutions like UTI, ICICI, IDBI, IFCI, LIC etc. in September 1992 specially to cater to small and medium sized companies with equity capital of more than Rs.30 lakh and less than Rs.25 crore. It helps entrepreneurs in raising finances for their new projects in a cost effective manner. It provides for nation-wide online ringless trading with 20 plus representative offices in all major cities of the country. On this stock exchange, securities of those companies can be traded which are exclusively listed on OTCEI only. In addition, certain shares and debentures listed with other stock exchanges in India and the units of UTI and other mutual funds are also allowed to be traded on OTCEI as permitted securities. It has been noticed that, of late, the turnover at this stock exchange has considerably reduced and steps have been afoot to revitalise it. In fact, as of now, BSE and NSE are the two Stock Exchanges, which enjoy nation-wide coverage and handle most of the business in securities in the country.

18.10 REGULATIONS OF STOCK EXCHANGES

As indicated earlier, the stock exchanges suffer from certain limitations and require strict control over their activities in order to ensure safety in dealings thereon. Hence, as early as 1956, the Securities Contracts (Regulation) Act was passed which provided for recognition of stock exchanges by the central Government. It has also the provision of framing of proper bylaws by every stock exchange for regulation and control of their functioning subject to the approval by the Government. All stock exchanges are required to submit information relating to its affairs as required by the Government from time to time. The Government was given wide powers relating to listing of securities, make or amend bylaws, withdraw recognition to, or supersede the governing bodies of stock exchange in extraordinary/abnormal situations. Under the Act, the Government promulgated the Securities Regulations (Rules) 1957, which provided *inter alia* for the procedures to be followed for recognition of the stock exchanges, submission of periodical returns and annual returns by recognised stock exchanges, inquiry into the affairs of recognised stock exchanges and their members, and requirements for listing of securities.

18.11 ROLE OF SEBI

As part of economic reforms programme started in June 1991, the Government of India initiated several capital market reforms, which included the abolition of the office of the Controller of Capital Issues (CCI) and granting statutory recognition to Securities Exchange Board of India (SEBI) in 1992 for:

(a) protecting the interest of investors in securities;

(b) promoting the development of securities market;

(c) regulating the securities market and

(d) matters connected therewith or incidental thereto.

SEBI has been vested with necessary powers concerning various aspects of capital market such as:

(i) regulating the business in stock exchanges and any other securities market;

(ii) registering and regulating the working of various intermediaries and mutual funds;

(iii) promoting and regulating self regulatory organisations;

(iv) promoting investors education and training of intermediaries;

(v) prohibiting insider trading and unfair trade practices;

(vi) regulating substantial acquisition of shares and take over of companies;

(vii) calling for information, undertaking inspection, conducting inquiries and audit of stock exchanges, and intermediaries and self regulation organisations in the stock market; and

(viii) performing such functions and exercising such powers under the provisions of the Capital Issues (Control) Act, 1947 and the Securities Contracts (Regulation) Act, 1956 as may be delegated to it by the Central Government.

Notes

As part of its efforts to protect investors' interests, SEBI has initiated many primary market reforms, which include improved disclosure standards in public issue documents, introduction of prudential norms and simplification of issue procedures. Companies are now required to disclose all material facts and risk factors associated with their projects while making public issue. All issue documents are to be vetted by SEBI to ensure that the disclosures are not only adequate but also authentic and accurate. SEBI has also introduced a code of advertisement for public issues for ensuring fair and truthful disclosures. Merchant bankers and all mutual funds including UTI have been brought under the regulatory framework of SEBI. A code of conduct has been issued specifying a high degree of responsibility towards investors in respect of pricing and premium fixation of issues. To reduce cost of issue, underwriting of issues has been made optional subject to the condition that the issue is not under-subscribed. In case the issue is under-subscribed i.e., it was not able to collect 90% of the amount offered to the public, the entire amount would be refunded to the investors. The practice of preferential allotment of shares to promoters at prices unrelated to the prevailing market prices has been stopped and private placements have been made more restrictive. All primary issues have now to be made through depository mode. The initial public offers (IPOs) can go for **book building** for which the price band and issue size have to be disclosed. Companies with dematerialised shares can alter the par value as and when they so desire.

As for measures in the secondary market, it should be noted that all statutory powers to regulate stock exchanges under the Securities Contracts (Regulation) Act have now been vested with SEBI through the passage of securities law (Amendment) Act in 1995. SEBI has duly notified rules and a code of conduct to regulate the activities of intermediaries in the securities market and then registration in the securities market and then registration with SEBI is made compulsory. It has issued guidelines for composition of the governing bodies of stock exchanges so as to include more public representatives. Corporate membership has also been introduced at the stock exchanges. It has notified the regulations on insider trading to protect and preserve the integrity of stock markets and issued guidelines for mergers and acquisitions. SEBI has constantly reviewed the traditional trading systems of Indian stock exchanges and tried to simplify the procedure, achieve transparency in transactions and reduce their costs. To prevent excessive speculations and volatility in the market, it has done away with badla system, and introduced rolling settlement and trading in derivatives. All stock exchanges have been advised to set-up clearing corporation / settlement guarantee fund to ensure timely settlements. SEBI organises training programmes for intermediaries in the securities market and conferences for investor education all over the country from time to time.

Notes

18.12 NATIONAL STOCK EXCHANGE OF INDIA (NSEI)

National Stock Exchange of India was recognised in 1992 and started working in 1994. Ringless trading takes place in NSEI i.e., the trading of securities takes place through network of computers. NSEI provide a nationwide transparent market for different types of securities.

Objective of NSEI

1. To provide a nationwide transparent market for all types of securities.
2. To ensure access to investors all over the country through an appropriate communication network.
3. To provide an efficient securities market using electronic trading systems.
4. To make available shorter settlement cycles and book entry settlement system.
5. To meet international standards.

18.12.1 Trading Procedure on a Stock Exchange

Now-a-days trading of securities has shifted from the floor of a stock exchange to the broker's office. Securities are bought and sold with the help of brokers who are members of a stock exchange. They act as intermediaries between buyers and sellers of securities.

Companies have to get their securities listed in the stock exchange for the purpose of trading through stock exchange. Trading procedure involves the following steps :

1. **Selection of Broker :** Firstly, investor chooses the broker through whom he will buy or sell the securities.
2. **Placement of Order :** After fixing the broker, the investor places the order stating the name of the company, number of shares to be bought or sold the price at which the transaction has to be made.
3. **Trade by the Broker :** Broker makes the deal if the desired price is quoted by any buyer/seller in his computer. Transactions on a stock exchange can be on cash basis or carryover basis (badla).
4. **Information to Investor :** The broker informs the investor about the deal. The buyer makes arrangement for payment.
5. **Settlement :** All transactions are settled through the clearing house through electronic book entry.

18.13 DEPOSITORY SERVICES

The Depositories Act 1996 introduced the depository service system in India. Under the depository system, physical securities are converted into electronic form thrugh the process of dematerialisation.

The constituents of the depository system are :

1. Depository
2. Depository Participants (DP)
3. Issuing Company
4. Investors

Depository is like a bank in which an investor can deposit and withdraw his shares. Depository Participant (DP) is an agent of the depository. Investors interact only with DPs. Any financial institution can become DP after registration with SEBI. The company whose shares are to be transacted in electronic form must be registered with a depository.

Investors who want to get securities in electronic form opens a Demat Account. Demat account is the abbreviation of dematerialised account. Demat account refers to an account which an Indian citizen must open with the DPs to trade in listed securities in electronic form. From this account one can hold shares of various companies in the dematerialised/electronic form.

The services provided by a depository are termed as 'Depository Services'. The name of two depositories in India are NSDL and CDSL. [National Securities Depository Ltd. and Central Depository Services Ltd.].

18.13.1 Services provided by Depository

1. Dematerialisation (demat) that is converting physical certificates to electronic form.
2. Rematerialisation (remat) that is getting physical certificates from the electroic securities. This is the reverse of demat.
3. Transfer of securities.
4. Settlement of trade.

Working of Depository System

Investor must submit Demat Request Form (DRF) along with the certificate to DP (Depository Participant). DP submits the DRF and share certificates to the issuing company and intimates the depository. The company verifies the DRF and share certificates. Then the company confirms the dematerialisation to the depository. Depository informs the same to DP. DP then credits investor's Demat account with the shares. DP sends a statement of account to the investor.

18.13.2 Benefits of Depository Services

Depository services are beneficial because of the following reasons:

1. Sale and purchase of shares and stocks of any company on any stock exchange is facilitated by depository services.

2. Saves time
3. No paperwork.
4. Lower transaction costs
5. Ease in trading
6. Transparency in transactions
7. Physical presence of investor is not required in stock exchange.
8. Risk of loss and mutilation of security certificate is eliminated.

INTEXT QUESTIONS 18.3

1. State any three main objectives for which SEBI was granted statutory recognition in 1992.
2. Give a specific term/name for the following:

   (a) The prominent stock exchange enjoying nation wide coverage that commenced operations in 1994.

   (b) The stock exchange that specially caters to small and medium-sized companies.

   (c) The first organised stock exchange in India.

   (d) The Act passed in the year 1956 for providing recognition of stock exchanges by the central government.

   (e) The regulatory body of stock exchanges in our country granted statutory recognition in the year 1992.
3. List any three primary market reforms initiated by SEBI.
4. Multiple Choice Questions :

   (i) NSDL is the name of _____________.

   a) Depository　　b) Company

   c) Investor　　d) None of the above

   (ii) Investor who wants to keep his securities in electronic form opens a ________ account with a Depository Participant.

   a) Savings　　b) Current

   c) Demat　　d) Both (a) and (b)

WHAT YOU HAVE LEARNT

- Financial market is the market that facilitates transfer of funds between investors/ lenders and borrowers/ users. It deals in financial instruments like bills of exchange, shares, debentures, bonds, etc. It provides security to dealings in financial assets, liquidity to financial assets for investors and ensures low cost of transitions and information.
- Financial Markets can be classified as (1) Money market and (2) Capital market.
- Money market refer to the network of financial institutions dealing in short term funds through instruments like bills of exchanges, promissory notes, commercial papers, treasury bills etc.
- Capital Market is an institutional arrangement for borrowing medium and long-term funds and which provides facilities for marketing and trading of securities. So it constitutes all long-term borrowings from banks and financial institutions, borrowings from foreign markets and raising of capital by issue of various securities such as shares debentures, bonds, etc.
- The securities market has two different segments namely primary and secondary market.
- The primary market consists of arrangements for procurement of long-term funds by companies by fresh issue of shares and debentures.
- The secondary market or stock exchange provides a ready market for existing long-term securities.
- Stock exchange is the secondary market, which provides a place for regular sale and purchase of different types of securities like shares, debentures, bonds & government securities. It is an organised market where all transactions are regulated by the rules and laws of the concerned stock exchanges.
- The functions of a stock exchanges are to provide ready and continuous market for securities, information about prices and sales, safety to dealings and investment, helps mobilisation of savings and capital formation. It acts as a barometer of economic and business conditions and helps in better allocation of funds.
- Stock exchanges provide many benefits to companies, investors and the society as a whole. But they also suffer from limitations like exclusive speculation and fluctuation in prices due to rumours and unpredictable events.
- Along with genuine investment, at times, stock exchange transactions may be undertaken by persons as a speculation.
- There are 23 stock exchanges in India presently, including BSE, NSE and OTCEI.

- Stock Exchanges are regulated by the Securities Contracts (Regulation) Act and by SEBI. SEBI has initiated a number of reforms in the primary and secondary market to regulate the stock market. Documentary and procedural requirements for listing and trading have been made stricter and foolproof to protect investors' interest.
- NSEI is the national level stock exchange.
- The main objective of NSEI is to provide a nationwide transparent market.
- Investor in share market open a demat account to keep these securities in electronic form.
- Investors approach depository participant for dematerialisation procedure.
- NSDL and CDSL are the two depositories in India.
- Services provided by Depository : dematerialisation, rematerialisation, transfer of securities, settlement of trade.
- Benefits of depository services include : saves time, no paperwork, lower transaction costs, ease in trading, transparency in transactions and elimination of risk of loss of security certificate.

KEY TERMS

Call money	Capital market	Certificate of deposit
Commercial paper	Financial Market	Money market
New issue market	NSE	OTCEI
Primary market	Rolling settlement	SEBI
Secondary market	Speculation	Stock exchange
Trade bill	Treasury bill	

TERMINAL EXERCISE

Very Short Answer Type Questions

1. What do you mean by 'Financial Market'?
2. Give four examples of credit instruments of money market.
3. State the meaning of capital market.
4. List any two advantages of stock exchanges to companies.
5. Mention the organisations that are part of the organised money market in India.

Notes

6. What do you mean by 'Depository'?
7. Give the full form of NSDL.
8. State the full form of CDSL.

Short Answer Type Questions

9. Define money market and explain its importance in a modern economy.
10. What is capital market? How does it differ from money market?
11. Distinguish between primary market and secondary market.
12. How does the stock exchange helps in mobilizing savings and capital formation?
13. Describe the measures taken by SEBI to regulate the secondary market.
14. What is meant by a 'Demat' account?
15. Anil wants to invest money in share market. As a financial advisor what will you suggest him to do?

Long Answer Type Questions

16. Define stock exchange and explain its functions.
17. Explain the importance of stock exchanges from the point of view of companies and investors.
18. Explain the role played by SEBI in protecting investors' interests and controlling the business at stock exchange.
19. Give explanatory notes on (a) stock exchange in India; and (b) Regulations of stock exchanges.
20. Describe the two components of the securities market, in detail.

ANSWERS TO INTEXT QUESTIONS

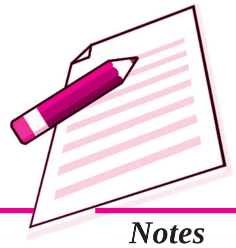
18.1

1. It is market that facilitates transfer of funds between investors/lenders and borrowers/users. It deals in financial instrument like bills of exchange, shares, debentures, bonds etc.
2. (a) (i) To raise long-term funds through fresh issue of securities

   (ii) Stock brokers who are members of the stock exchange and mutual funds, financial institutions, and individual investors,

   (iii) Listing in stock exchange is required to deal in a security in the stock exchange.

   (iv) Prices are determined by the company/institution's management, with due confirmation with SEBI.



(b)

Point of Distinction	*Capital Market*	*Money Market*
1. Time period / Term	Long term funds dealt with	Deals in short-term funds.
2. Instrument Dealt In	Deals in shares, debenture, bonds and government securities.	Deals in securities like treasury bills, commercial paper, bills of exchange, certificate of deposits etc.
3. Participants	Stock brokers, underwriters, mutual funds, financial institutions and individual investors.	Participants are commercial banks, non-banking finance companies, chit funds etc.
4. Regulatory body	SEBI (Securities and Exchange Board of India.)	RBI (Reserve Bank of India)

18.2 2. (a) False: Stock Exchange provides a ready market for sale and purchase of various shares, debentures, bonds and government securities.
(b) False: In the stock exchange, transactions take place between its members or their authorised agents.
(c) True
(d) False: It becomes easy for investors to raise loans from banks against collateral of their holdings in securities traded at the stock exchange.
(e) False: Speculation is different from gambling.

3. (a) Excessive speculation
(b) fluctuation in security prices due to unpredictable political, social and economic factors as well as on account of rumours spread.

18.3 1. (a) protecting interest of investors
(b) promoting development of securities market
(c) regulating the securities market.

2. (a) National Stock Exchange (NSE)
(b) Over The Counter Exchange of India (OTCEI)
(c) Bombay Stock Exchange (BSE)
(d) Securities Contracts (Regulation) Act.
(e) Securities and Exchange Board of India (SEBI)

3. (i) Improved disclosure standards in public issue documents.
(ii) Introduction of prudential norms.
(iii) Simplification of the issue procedures.

4. (i) a (ii) c

Notes

DO AND LEARN

1. Identify any two persons in your vicinity who are associated with the financial market/ stock exchanges, either as an investor or as a stockbroker. Talk to them and find out (i) how sale and purchase of securities takes place; (ii) what are the popular instruments traded in the market and (iii) about recent SEBI/ government guidelines that may have affected their transactions.
2. Read the Business Section of a daily newspaper or a specialised Business Newspaper. Locate the segment where share prices of important stock exchanges are given. Select any five companies and record their share prices everyday for a period of three weeks. Observe their price movement and see how major events in the economic, political or social environment affect the prices of these shares. You may even get information about these share prices from the television.

ROLE PLAY

Sunita and Kavita are good friends. Kavita is very god-fearing kind, while Sunita was an enterprising person, having practical in approach. Read the following conversation.

Kavita : Hi, Sunita! What are you doing?

Sunita : Hi, I am reading the newspaper - financial market page that gives us information about the shares price.

Kavita : Shares, that is an area of big gambles.

Sunita : No, not really! You must understand how it works.

Kavita : Frankly speaking, I think this Capital market is all a gambling game and I don't see any use of them.

Sunita : No, you are seriously mistaken; you do not know the importance of capital market. I will tell how it is needed for an individual and an economy.

You are required to play the role of Sunita and continue the conversation.

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19

INTRODUCTION TO MARKETING

We use a large variety of goods and services in our daily life. These include items like toothpaste, toothbrush, soap, oil, clothes, food items, telephone, electricity and many more. How do all these goods and services reach our home? Obviously the business houses who produce the goods and services have to ensure that these are to be sold, and so they have to make the consumers/users aware of their products and place them at points convenient to the consumers. This involves a number of activities such as product planning, pricing, promotion, use of middlemen (wholesalers, retailer etc.) for sale, warehousing, transportation etc. All these activities taken together are termed as Marketing. In this lesson, we will learn about the concept of marketing, its importance, objectives and functions.

OBJECTIVES

After studying this lesson, you will be able to:

- explain the meaning of marketing;
- differentiate between 'marketing' and 'selling';
- describe the importance of marketing;
- state the objectives of marketing and
- explain the various functions of marketing.

19.1 MEANING OF MARKETING

We know that the businessman produces goods and services for our use. These are not necessarily produced at the places where they are consumed or used. Even in villages, now-a-days you find the products manufactured all over India and in other countries are used. This implies that the manufacturers must be making efforts to ensure that their products are in demand and reach the ultimate consumers all over the globe. So, when you go to the market to buy a readymade shirt you find that there are several options available to you in terms of quality of cloth used, design, colour, price etc. and you can buy what suits you most. This also implies that the manufactures assess the needs of the consumers, their tastes and preferences and plan the products accordingly. Not only that, they also ensure that people are aware about the product and its features. All these activities are said to be part of marketing function of any organisation. Thus, marketing refers to the process of ascertaining consumers' needs and supplying various goods and services to the final consumers or users to satisfy those needs. Basically, marketing is the performance of business activities that direct the flow of goods and services from producers to consumers or users.

The American Marketing Association defines marketing as an organisational function and set of processes for creating, communicating and delivering value to customers and for managing customer relationships in ways that benefit the organisation and its stakeholders.

19.1.1 Traditional Concept of Marketing

According to the traditional concept, marketing means selling goods and services that have been produced. Thus, all those activities which are concerned with persuasion and sale of goods and services, are called marketing. This concept of marketing emphasises on promotion and sale of goods and services and little attention is paid to consumer satisfaction. This concept has the following implications:

(a) The main focus of this concept is on product, i.e., we have a product and it has to be sold. So, we have to persuade the consumers to buy our product.

(b) All efforts of the marketing people are concentrated on selling the product. They adopt all means like personal selling and sales promotion to boost the sales.

(c) The ultimate goal of all marketing activity is to earn profit through maximisation of sales.

Traditional Concept of Marketing	
Focus on	Product
Means	Selling
Ends	Profits through maximisation of sales

19.1.2 Modern Concept of Marketing

The modern concept of marketing considers the consumers' wants and needs as the guiding spirit and focuses on the delivery of such goods and services that can satisfy those needs most effectively. Thus, marketing starts with identifying consumer needs, then plan the production of goods and services accordingly to provide him the maximum satisfaction. In other words, the products and services are planned according to the needs of the customers rather than according to the availability of materials and machinery. Not only that, all activities (manufacturing, research and development, quality control, distribution, selling etc.) are directed to satisfy the consumers. Thus, the main implications of the modern concepts are:

(a) The focus of this concept is on customer orientation. The marketing activity starts with an assessment of the customers needs and plan the production of items that satisfy these needs most effectively. This also applies to all other marketing activities like pricing, packaging, distribution and sales promotion.

(b) All marketing activities like product planning, pricing, packaging, distribution and sales promotion are combined into one as coordinated marketing efforts. This is called integrating marketing. It implies:

   (i) developing a product that can satisfy the needs of the consumers;

   (ii) taking promotional measures so that consumers come to know about the products, its features, quality, availability etc.;

   (iii) pricing the product keeping in mind the target consumers' purchasing power and willingness to pay;

   (iv) packaging and grading the product to make it more attractive and undertaking sales promotion measures to motivate consumers to buy the product; and

   (v) taking various other measures (e.g., after sales service) to satisfy the consumers' needs.

(c) The main aim of all effort is to earn profit through maximisation of customer satisfaction. This implies that, if the customers are satisfied, they will continue to buy, and many new customers will be added. This will lead to increased sales and so also the profits.

Modern Concept of Marketing	
Focus on	Customers' need
Means	Coordinated marketing efforts
Ends	Profits through customers' satisfaction

It may be noted that with growing awareness of the social relevance of business, marketing has to take into account the social needs and ensure that while enhancing consumer satisfaction, it also aims at society's long-term interest.

19.1.3 Marketing Management Philosophies

Different producers lay different emphasis of different aspects of the concept of marketing. The making concept is characterised according to the philosophy of the producer. Seeing the outlook of the producers of the marketing concept may be looked at in the following works:

i. **Production Concept :** In earlier days, selling was not a problem. So business organisations followed production concept. This concept means profits could be increased by producing large quantity of goods reducing the cost of production. a limitation of this concept is that quality conscious customers hesitate in buying.

ii. **Product Concept :** The producer os this class lay emphasis on the quality of products and services. As variety of products came in the society, customers began to prefer product of good quality and features. For example, normal toothpaste is not preferred when compared with toothpaste with salt [or with any other protective items]

iii. **Selling Concept :** In order to survive and grow business firms adopted aggressive selling technique to attract customers to buy their product. Sales persons started using unfair practices like cheating the customers with defective products as their main target is to earn money from the product.

iv. **Marketing Concept :** Business firms adopting marketing concept, identified that consumer needs and wants must be considered which producing a product. Before starting productions, the target market for the product should be identified. Under marketing concept, customer satisfaction is the key to maximise profits.

v. **Societial Marketing Concept :** In order to survive and grow business must satisfy the interest of society and the interest of customers. Under this concept, social welfare should be dalt by business firms. Public health, education, environmental protection etc. are some of the social goals to be considered.

INTEXT QUESTIONS 19.1

1. Define the term marketing.
2. Followings are the statements related to different concept of marketing. Identify those pertain to modern concept by mentioning 'MCM' and traditional concept by mentioning 'TCM' in the specified box given against each statement.

Notes

(a) It focuses on customer's need. ☐

(b) It focuses on product. ☐

(c) It sells satisfaction. ☐

(d) It sells goods and services. ☐

(e) It earns profit by maximisation of sales. ☐

(f) It earns profit through maximisation of customer satisfaction. ☐

19.2 DIFFERENCE BETWEEN MARKETING AND SELLING

The terms 'marketing' and 'selling' are related but not synonymous. 'Marketing' as stated earlier, emphasises on earning profits through customer satisfaction. In marketing, the focus is on the consumer's needs and their satisfaction. 'Selling' on the other hand focuses on product and emphasises on selling what has been produced. In fact it is a small part of the wide process of marketing wherein emphasis is initially on promotion of goods and services and eventually on increase in sales volume.

Marketing has long term perspective of winning over consumer loyalty to the product by providing him maximum satisfaction. However, selling has short-term prospective of only increasing the sales volume.

In marketing, the consumer is the king whose needs must be satisfied. In selling, the product is supreme and the entire focus is its sale. Marketing starts before production and continues even after the exchange of goods and services has taken place. It is so because provision of after sale service is an important component of marketing process. Selling starts after the production and ends as soon as the exchange of goods and services has taken place.

Marketing	*Selling*
Marketing includes selling and other activities like various promotional measures, marketing research, after sales service, etc.	Selling is confined to persuasion of consumers to buy firm's goods and services.
It starts with research on consumer needs, wants, preference, likes, dislike etc., and continues even after the sales have taken place.	Selling starts after the production process is over and ends with the handing over the money to the seller by the buyer.
Focus is on earning profit through maximisation of customers' satisfaction.	Focus is on earning profit through maximisation of sales.

Customer's need is the central point around whom all marketing activities revolve.	Fragmented approach to achieve short-term gain.
It is an integrated approach to achieve long term goals like creating, maintaining and retaining the customers.	All activities revolve around the product that has been produced.
Stresses on needs of buyer.	Stresses on needs of the seller.

A Few Relevant Terms on Marketing

- **Market :** Normally people understand the term market as a place where goods are bought and sold. But, in the context of Marketing, it refers to a group of buyers for a particular product or service. For example, the market for Accountancy textbooks consists of students in Commerce and specialised Accountancy Programmes; the market for ladies readymade garments consists of girls and women, and so on.

Types of Market

According to Area	*According to Goods and Commodities*	*According to Volume of transaction*
• Local Market • Regional Market • Rural Market • National Market • International Market	• Fruit Market • Furniture Market • Stock Market and so on.	• Wholesale Market • Retail Market

- **Marketeer :** It refers to the person who organises the various marketing activities such as market research, product planning, pricing, distribution etc.

- **Seller :** It refers to a person or organisation who is directly involved in the process of exchange of goods and services for money. This includes the wholesaler, retailer, etc.

- **Buyer :** A buyer is one who is directly involved in the process of purchase of goods and services. He/she is one who selects the goods, makes payment and takes the delivery.

- **Consumer :** One who actually uses the product or service. For example, you bought a shirt and gifted it to your friend who uses it. Here your friend is the consumer and you are a buyer. However, a consumer can also be the buyer.

- **Customer :** A customer usually refers to the person who takes the buying decision. For example, in a family, father decides on the brand of the toothpaste to be used by his children. Here, the children are the consumers and the father is the customer. A customer can also be the consumer. Similarly, the buyer may be different from the customer or one can be the customer as well as the buyer.

- **Virtual Market :** With advancement of technology, the buyer and sellers can, now-a-days, interact with each other by using Internet. This is called virtual market.

INTEXT QUESTIONS 19.2

1. Following is a list of statements regarding features of 'marketing' and 'selling'. Identify the features of marketing by mentioning 'M' and of selling by mentioning 'S' in box given against each.

   (a) It starts after the production process is over. ☐

   (b) All activities revolve around the product that has been produced. ☐

   (c) Customer is the central point. ☐

   (d) Satisfaction of the customer is the main focus. ☐

   (e) Target is to achieve shot-term gain. ☐

   (f) It is an integrated approach to achieve long-term goals. ☐

2. Complete the following table.

Types of Market

According to Area	(a)	Local Market
	(b)	Regional Market
	(c)	________________
	(d)	________________
	(e)	International Market
According to Volume of transaction	(a)	________________
	(b)	Wholesale Market

19.3 IMPORTANCE OF MARKETING

Marketing is important to the business, consumer as well as the society. This is evident from the following points.

Notes

(a) Marketing helps business to keep pace with the changing tastes, fashions, preferences of the customers. It works out primarily because ascertaining consumer needs and wants is a regular phenomenon and improvement in existing products and introduction of new product keeps on taking place. Marketing thus, contributes to providing better products and services to the consumers and improve their standard of living.

(b) Marketing helps in making products available at all places and throughout the year. We are able to get Kashmir shawls and Assam Tea all over India and get seasonal fruits like apple and oranges round the year due to proper warehousing or proper packaging. Thus, marketing creates time and place utilities.

(c) Marketing plays an important role in the development of the economy. Various functions and sub-functions of marketing like advertising, personal selling, packaging, transportation, etc. generate employment for a large number of people, and accelerate growth of business.

(d) Marketing helps the business in increasing its sales volume, generating revenue and ensuring its success in the long run.

(e) Marketing also helps the business in meeting competition most effectively.

19.4 OBJECTIVES OF MARKETING

After knowing the points of importance of marketing let us discuss on the basic objectives of marketing.

(a) Provide Satisfaction to Customers : All marketing activities are directed towards customer satisfaction. Marketing starts with ascertaining consumer needs and produce goods that satisfy those needs most effectively. Not only that the pricing and distribution functions of marketing are also planned accordingly.

(b) Increase in Demand : Through advertising and other sales promotional efforts, marketing aims at creating additional demand for their products. Satisfied customers also help in creating new customers. For example, if you buy a 'gel pen' and feel satisfied, next time also you will buy the same pen and obviously when you tell others about it they will also feel like giving it a try.

(c) Provide Qetter Quality Product to the Customers : This is a basic objective of marketing. The business houses try to update and upgrade their knowledge and technology to continuously provide better products. If they do not do so, they will be phased out through competition.

(d) Create Goodwill for the Organisation : Another objective of marketing is to build a good public image and create goodwill for the organisation. This helps in maintaining loyalty to the product and accepting new products of the same company.

(e) **Generate Profitable Sales Volume :** The ultimate objective of all marketing efforts is to generate profitable sales volumes for the business. Taking care of customer needs and wants by providing the required goods and services at prices they can afford, and at places and time that are convenient to them ultimately lead to increased sales and profits.

INTEXT QUESTIONS 19.3

1. State any two points of importance of marketing to consumer.

2. Given below are words in two columns, A and B. You have to match the words of column A with words of column B, so that the matched words describe an objective of marketing. Write the serial number of words in column B against the matched words of column A.

	A		B
(a)	Customer	(i)	Goodwill
(b)	Increase in	(ii)	Sales volume
(c)	Profitable	(iii)	Product
(d)	Better Quality	(iv)	Satisfaction
(e)	Create	(v)	Demand

19.5 FUNCTIONS PERFORMED IN MARKETING

You have learnt that marketing is the performance of those business activities that direct the flow of goods and services from producers to consumers or users. Let us now learn what those activities are? These are briefly discussed hereunder.

1. **Marketing Research :** Marketing research involves collection and analysis of facts relevant to various aspects of marketing. It is a process of collecting and analysing information regarding customer needs and buying habits, the nature of competition in the market, prevailing prices, distribution network, effectiveness of advertising media, etc. Marketing research gathers, records and analyses facts for arriving at rational decisions and developing suitable marketing strategies.

2. **Product Planning and Development :** As you know marketing starts much before the actual production. The marketeers gather information regarding what are the needs of the consumers and then decide upon what to produce. So, the task of marketing begins with planning and designing a product for the consumers. It can also be done while modifying and improving an already existing product.

For example, now-a-days we find much better soaps and detergent powders than we used to get earlier. Similarly, we have many new products introduced almost on a regular basis.

3. **Buying and Assembling :** Buying and assembling activities as a part of marketing refer to buying and collection of required goods for resale. This function of marketing is primarily relevant to those business organisations that are engaged in trading activities. In the context of manufacturing organisations, buying and assembling involves buying raw materials and components required for production of finished goods.

4. **Packaging :** Packaging involves putting the goods in attractive packets according to the convenience of consumers. Important considerations to be kept in view in this connection are the size of the package and the type of packaging material used. Goods may be packaged in bottles (plastic or glass), boxes (made of tin, glass, paper, plastic), cans or bags. The size of the package generally varies from a few grams to a few kilograms, one piece to a number of pieces of a product, or in any other suitable quantity in terms of weight, count, length etc. Packaging is also used as a promotional tool as suitable and attractive packages influences the demand of the products. It may be noted that packaging is different from packing, which refers to putting goods in suitable containers for transportation purposes.

5. **Standardisation and Grading :** Standardisation refers to development of standards for production of goods with respect to shape, design, colour and other characteristics. If products are standardised, customers are able to identify a product and its characteristics very well. So goods can be sold by sample or description. Standardisation helps in promoting the sale of the product by increasing consumers' confidence in the product quality.

   Grading involves separating products into different classes on the basis of certain predetermined standards relating to size and quality. Grading is required in case of agricultural, forest and mineral products such as cotton, sugar cane, iron ore, coal, timber, etc.

6. **Branding :** Branding means giving an attractive name, symbol or identity mark to the product to make a product different from others so that it is known by that name or symbol or mark. For example, Surf is the brand name of a detergent powder produced by Hindustan Unilever Limited (HUL). Similarly, you must be familiar with brands like Colgate for toothpaste, Lux for soap and so on.

7. **Pricing the Product :** Pricing involves decisions regarding fixation of product prices, keeping in view the product costs, the capacity of customers to pay, and the prices of the competitive products. It is an important decision as it influences the sales and so also the profits. So pricing has to be done very carefully.

8. **Promotion of the Product :** Promotional activities include advertising, personal selling, sales promotion and publicity. All promotional activities involve communication with the existing and prospective customers whereby they are made aware of the product, its distinctive features, price, availability etc. The objective of promotional activities is to motivate the customers to buy the product.

9. **Distribution :** Distribution refers to those activities that are undertaken for sale of products to the customers and the physical transfer thereof. The first aspect i.e., sale of product involves use of middlemen such as wholesalers and retailers whose services are used for making the products available at convenient points and helping in their sale to the ultimate consumers. The second aspect i.e., physical transfer involves warehousing and transportation of goods from the point of production to the point of sale or the consumer. The objective of distribution activities is to ensure that consumers get the goods and services at the place and time most convenient to them and in the desired quantity.

10. **Selling :** Selling is an important function of marketing whereby the ownership of goods and services is transferred from the seller to the buyer for a consideration known as price. To initiate and complete the process of selling, the seller has to inform the prospective buyer about availability of goods, the nature and uses of products, their prices and the needs of the customers that may be effectively satisfied by the product. In the process, he arouses customers' interest in the product and persuades them to buy it.

11. **Storage and Warehousing :** Storage refers to holding and preserving goods from the time of their procurement or production till the time of their sale. In other words storage involves making suitable arrangements for preserving the goods till they are bought by the consumers and delivered to them. Warehousing is synonymous to storage but is normally used for large-scale storage facility for goods and commodities. You must have seen cold store where vegetables like tomato, cabbage, potato etc. are stored to be consumed throughout the year. In marketing it is essential to store raw material and finished goods to be used later by the company for production or for resale.

12. **Transportation :** Transportation refers to the physical movement of goods from one place to another. In marketing, transport as an activity refers to physical movement of raw materials as well as finished goods from the place of production to place of consumption. Goods are transported through various means like railways, roadways, waterways and airways. For heavy and bulky goods, the railways and waterways are the best. For other goods, it depends upon the demand, cost involved, urgency, nature of the goods etc. to decide about a suitable means of transportation.

Notes

INTEXT QUESTIONS 19.4

1. Define the term Grading.
2. Following are the statements pertaining to functions performed in marketing. Identify the function of marketing from each statement.
   (a) Physical movement of goods from one place to another.
   (b) Holding and preserving goods from the time of their procurement or production till the time of their sale.
   (c) Collection and analysis of relevant facts to solve marketing problems.
   (d) This include advertising, personal selling, sales promotion and publicity.
   (e) Separating products into different classes on the basis of certain predetermined standards.

WHAT YOU HAVE LEARNT

- Marketing refers to the process of ascertaining consumers' needs and supplying various goods and services to the final consumers or users to satisfy those needs.
- Traditionally marketing was synonymous with selling of goods and services. This concept of marketing emphasises on promotion and sale of goods and services and little attention is paid to consumer satisfaction.
- According to modern concept, marketing starts with identifying consumers needs, then plan the production of goods and services accordingly to provide them the maximum satisfaction.
- The terms 'marketing' and 'selling' are related but not synonymous. While selling starts after production is over, marketing starts with finding out consumers' needs, wants and preferences. Marketing revolves around the customers, whereas selling revolves around the product. Marketing seeks customers' satisfaction, selling seeks profits.
- Marketing helps business to keep pace with the changing tastes of the consumers and meeting the threats posed by competitors. It helps in providing better goods and services to the consumers, serves consumers by providing product irrespective of time and place and also by providing a wide range of product in different size, quality, prices etc.

- Marketing aims to achieve many objectives. It provides better quality products to the customers to fulfill their needs. It also creates demand of the product in the market by using various promotional tools. It helps in creating new customers, maintaining old customers, and generating profit and goodwill for the business.
- Marketing performs many functions like marketing research, product planning and development, buying and assembling, packaging, standardisation and grading, branding, pricing the product, promotion of the product, distribution, selling, storage and warehousing and transportation.

KEY TERMS

Branding	Buyer	Consumer
Customer	Grading	Marketeer
Marketing	Marketing Research	Packaging
Packing	Selling	Virtual Market

TERMINAL EXERCISE

Very Short Answer Type Questions

1. Define the term Market?
2. Who is termed as Marketeer?
3. What is meant by the term 'Grading'?
4. What is the purpose of marketing as per traditional concept?
5. Name the four activities included in promotion of the product.

Short Answer Type Questions

6. Explain the modern concept of marketing.
7. Distinguish between traditional and modern concept of marketing.
8. Explain 'packaging' as a function of marketing.
9. What is meant by integrating marketing?
10. Explain the significance of marketing research.

Long Answer Type Questions

11. State any four points of the importance of marketing.

12. Do you think marketing and selling are synonymous terms? Give reason.
13. Explain any three objectives of marketing.
14. Describe any four important functions of marketing.
15. Define marketing and distinguish it from selling.

ANSWERS TO INTEXT QUESTIONS

19.1

1. It is an organisational function and set of processes for creating, communicating and delivering value to customers and for managing customer relationships in ways that benefit the organisation and its stakeholders.
2. MCM: (a), (c), (f)   TCM: (b), (d), (e)
3. (c)
4. (d)

19.2

1. M : (c), (d), (f)   S : (s), (b), (e)
2. **Types of Market**

According to Area	(a)	Local Market
	(b)	Regional Market
	(c)	Rural Market
	(d)	National Market
	(e)	International Market
According to Volume of transaction	(a)	Retail Market
	(b)	Wholesale Market

19.3

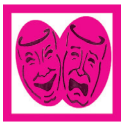
1. (a) Marketing provides better products and services to the customers.
   (b) Marketing helps in making products available irrespective of time and place.
2. (a) iv   (b) v   (c) ii   (d) iii   (e) i

19.4

1. Grading is the process of seprating the products into different classes on the basis of certain predetermined standards relating to size and quality.
2. (a) Transportation   (b) Storage and warehousing
   (c) Marketing research   (d) Promotion of Product
   (e) Grading

DO AND LEARN

We use a number of products in our daily life. Make a list of any three such products and ask your friends and family members as to what tare their likes/dislikes about these products. Ask them to suggest changes in these products, which would make them more popular.



ROLE PLAY

Surinder is a successful businessman. During morning walk in the park, he met his neighbour, Amit, another businessman.

Surinder : Hello Mr. Amit, how is your business doing?

Amit : Surinderji, things are not very bright. I launched three ready to eat products one after another, but all failed in the market. I am very upset and confused.

Surinder : But did you analyse why it happened?

Amit : No, you can never predict Indian consumers' likes and dislikes.

Surinder : No, you are wrong. Reason of failure of your products lies elsewhere. You must have given more emphasis on selling rather than marketing.

Amit : But, I think both are synonymous.

Surinder : Both are related terms but not synonymous.

Surinder explained to Amit the relationship between selling and marketing and the difference between the two.

Put yourself in place of Surinder and your friend in place of Amit and continue the conversation.

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MARKETING MIX

In the previous lesson you learnt that marketing identifies consumers' needs and supplies various goods and services to satisfy those needs most effectively. So the businessman needs to: (a) produce or manufacture the product according to consumers' need; (b) make available it at a price that the consumers' find reasonable; (c) supply the product to the consumers at different outlets they can conveniently approach; and (d) inform the consumers about the product and its characteristics through the media they have access to.

So the marketing manager concentrates on four major decision areas while planning the marketing activities, namely, (i) products, (ii) price, (iii) place (distribution) and (iv) promotion. These 4 'P's are called as elements of marketing and together they constitute the marketing mix. All these are inter-related because a decision in one area affects decisions in other areas. In this lesson you will learn about the basic aspects relating to these 4 'P's viz., product, price, place and promotion.

OBJECTIVES

After studying this lesson, you will be able to :

- explain the concept of marketing mix and its components;
- explain the meaning of product and its classification;
- state the various factors affecting pricing decisions;
- describe different methods of pricing;
- state the meaning of channels of distribution;
- identify the various channels of distribution;

- state the factors affecting choice of a channel of distribution; and
- explain the concepts of promotion and promotion mix.

20.1 CUSTOMER : KING OF THE MAEKET

Now a day the customer is considered as the king of the market. Thus all the firms should constrate on customers requirement and satisfaction. Now a day compinies are shaping seperate offers, services and messages to indiviusals customers. Many companies collect information on each customers past transaction, demographics, psyphographics, and media and distribution references. They hope to achieved profitable growth through capturing a larger share of each customers expenditure by building high customer loylty and focusing on customer life time value.

20.2 CONCEPT AND COMPONENTS OF MARKETING MIX

Marketing involves a number of activities. To begin with, an organisation may decide on its target group of customers to be served. Once the target group is decided, the product is to be placed in the market by providing the appropriate product, price, distribution and promotional efforts. These are to be combined or mixed in an appropriate proportion so as to achieve the marketing goal. Such mix of product, price, distribution and promotional efforts is known as 'Marketing Mix'.

According to Philip Kotler "Marketing Mix is the set of controllable variables that the firm can use to influence the buyer's response". The controllable variables in this context refer to the 4 'P's [product, price, place (distribution) and promotion]. Each firm strives to build up such a composition of 4'P's, which can create highest level of consumer satisfaction and at the same time meet its organisational objectives. Thus, this mix is assembled keeping in mind the needs of target customers, and it varies from one organisation to another depending upon its available resources and marketing objectives. Let us now have a brief idea about the four components of marketing mix.

- **Product :** Product refers to the goods and services offered by the organisation. A pair of shoes, a plate of dahi-vada, a lipstick, all are products. All these are purchased because they satisfy one or more of our needs. We are paying not for the tangible product but for the benefit it will provide. So, in simple words, product can be described as a bundle of benefits which a marketeer offers to the consumer for a price. While buying a pair of shoes, we are actually buying comfort for our feet, while buying a lipstick we are actually paying for beauty because lipstick is likely to make us look good. Product can also take the form of a service like an air travel, telecommunication, etc. Thus, the term product refers to goods and services offered by the organisation for sale.

- **Price :** Price is the amount charged for a product or service. It is the second most important element in the marketing mix. Fixing the price of the product is a tricky job. Many factors like demand for a product, cost involved, consumer's ability to pay, prices charged by competitors for similar products, government restrictions etc. have to be kept in mind while fixing the price. In fact, pricing is a very crucial decision area as it has its effect on demand for the product and also on the profitability of the firm.

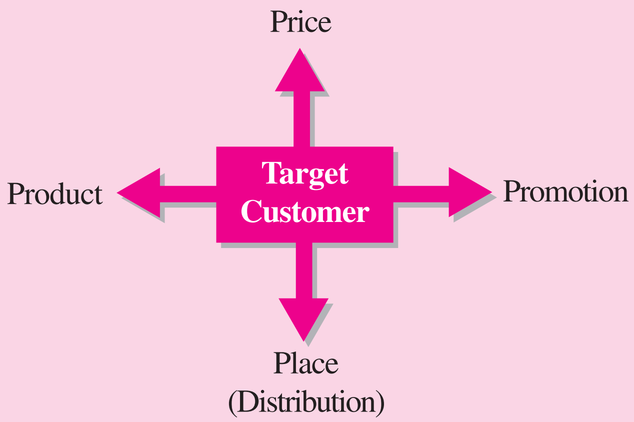
- **Place :** Goods are produced to be sold to the consumers. They must be made available to the consumers at a place where they can conveniently make purchase. Woollens are manufactured on a large scale in Ludhiana and you purchase them at a store from the nearby market in your town. So, it is necessary that the product is available at shops in your town. This involves a chain of individuals and institutions like distributors, wholesalers and retailers who constitute firm's distribution network (also called a channel of distribution). The organisation has to decide whether to sell directly to the retailer or through the distributors/wholesaler etc. It can even plan to sell it directly to consumers. The choice is guided by a host of factors about which you will learn later in this chapter.

- **Promotion :** If the product is manufactured keeping the consumer needs in mind, is rightly priced and made available at outlets convenient to them but the consumer is not made aware about its price, features, availability etc, its marketing effort

Notes

may not be successful. Therefore promotion is an important ingredient of marketing mix as it refers to a process of informing, persuading and influencing a consumer to make choice of the product to be bought. Promotion is done through means of personal selling, advertising, publicity and sales promotion. It is done mainly with a view to provide information to prospective consumers about the availability, characteristics and uses of a product. It arouses potential consumer's interest in the product, compare it with competitors' product and make his choice. The proliferation of print and electronic media has immensely helped the process of promotion.

Marketing Mix : A bird's eye view



Having acquainted ourselves with the broad nature of the four components of marketing mix, let us now learn some important aspects of each one of these in detail in the following sections.

INTEXT QUESTIONS 20.1

1. List the four components of marketing mix
2. Give one word/phrase for the following statements :
   (a) The crucial decision area of marketing that has direct effect on demand for the product and profitability of the firm.
   (b) The component of marketing that relates to channels of distribution.
   (c) The components that are combined to achieve the marketing goal.
   (d) The goods and services offered by the organisation for sale.
   (e) The ingredient of marketing mix relating to informing, persuading and influencing a consumer to make choice of the product to be bought.

20.3 CONCEPT OF PRODUCT AND ITS CLASSIFICATION

As stated earlier, product refers to the goods and services offered by the organisation for sale. Here the marketers have to recognise that consumers are not simply interested in the physical features of a product but a set of tangible and intangible attributes that satisfy their wants. For example, when a consumer buys a washing machine he is not buying simply a machine but a gadget that helps him in washing clothes. It also needs to be noted that the term product refers to anything that can be offered to a market for attention, acquisition, or use. Thus, the term product is defined as "anything that can be offered to a market to satisfy a want". It normally includes physical objects and services. In a broader sense, however, it not only includes physical objects and services but also the supporting services like brand name, packaging accessories, installation, after sales service etc. Look at the definitions by Stanton and McCarthy as given in the box.

Product

"Product is a set of tangible and intangible attributes including packaging, colour, price, manufacturer's prestige, retailer's prestige and manufacturer's and retailer's services which buyer may accept as offering satisfaction of wants and services". ***..... William J. Stanton***

"A product is more than just a physical product with its related functional and aesthetic features. It includes accessories, installation, instructions on use, the package, perhaps a brand name, which fulfills some psychological needs and the assurances that service facilities will be available to meet the customer needs after the purchase". ***..... Jerome McCarthy***

Product Classification

Product can be broadly classified on the basis of (1) use, (2) durability, and (3) tangibility. Let us have a brief idea about the various categories and their exact nature under each head, noting at the same time that in marketing the terms 'product' and 'goods' are often used interchangeably.

1. Based on use, the product can be classified as:

(a) **Consumer goods :** Goods meant for personal consumption by the households or ultimate consumers are called consumer goods. This includes items like toiletries, groceries, clothes etc. Based on consumers' buying behaviour the consumer goods can be further classified as :

(i) ***Convenience Goods :*** Do you remember, the last time when did you buy a packet of butter or a soft drink or a grocery item? Perhaps you don't remember, or you will say last week or yesterday. Reason is, these goods belong to the categories of convenience goods which are bought frequently

without much planning or shopping effort and are also consumed quickly. Buying decision in case of these goods does not involve much pre-planning. Such goods are usually sold at convenient retail outlets.

(ii) ***Shopping Goods :*** These are goods which are purchased less frequently and are used very slowly like clothes, shoes, household appliances. In case of these goods, consumers make choice of a product considering its suitability, price, style, quality and products of competitors and substitutes, if any. In other words, the consumers usually spend a considerable amount of time and effort to finalise their purchase decision as they lack complete information prior to their shopping trip. It may be noted that shopping goods involve much more expenses than convenience goods.

(iii) ***Speciality Goods :*** Because of some special characteristics of certain categories of goods people generally put special efforts to buy them. They are ready to buy these goods at prices at which they are offered and also put in extra time to locate the seller to make the purchase. The nearest car dealer may be ten kilometres away but the buyer will go there to inspect and purchase it. In fact, prior to making a trip to buy the product he/she will collect complete information about the various brands. Examples of speciality goods are cameras, TV sets, new automobiles etc.

(b) Industrial Goods : Goods meant for consumption or use as inputs in production of other products or provision of some service are termed as ‘industrial goods’. These are meant for non-personal and commercial use and include (i) raw materials, (ii) machinery, (iii) components, and (iv) operating supplies (such as lubricants, stationery etc). The buyers of industrial goods are supposed to be knowledgeable, cost conscious and rational in their purchase and therefore, the marketeers follow different pricing, distribution and promotional strategies for their sale.

It may be noted that the same product may be classified as consumer goods as well as industrial goods depending upon its end use. Take for example the case of coconut oil. When it is used as hair oil or cooking oil, it is treated as consumer goods and when used for manufacturing a bath soap it is termed as industrial goods. However, the way these products are marketed to these two groups are very different because purchase by industrial buyer is usually large in quantity and bought either directly from the manufacturer or the local distributor.

2. Based on Durability, the products can be classified as :

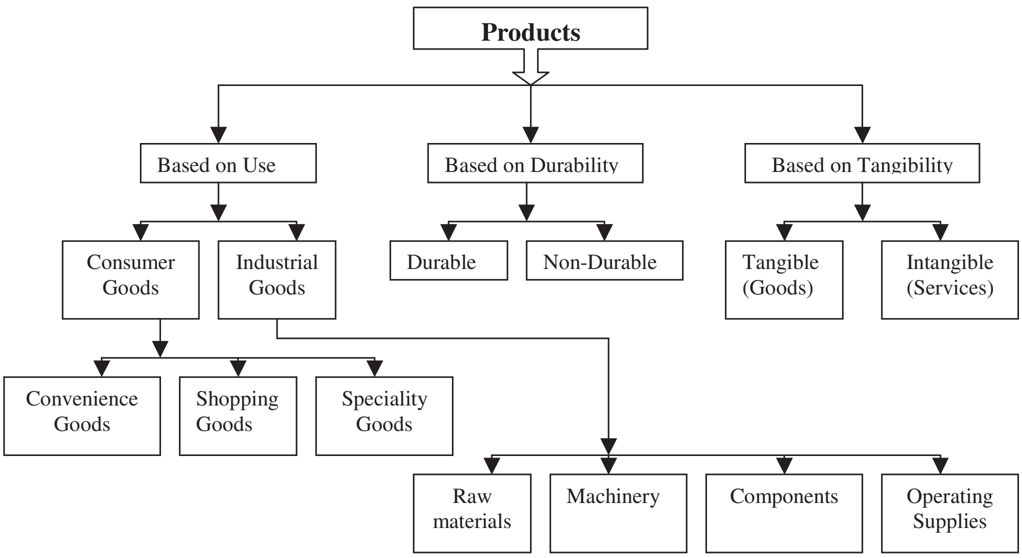
(a) Durable Goods : Durable goods are products which are used for a long period i.e., for months or years together. Examples of such goods are refrigerator, car, washing machine etc. Such goods generally require more of personal selling efforts and have high profit margins. In case of these goods, seller’s reputation and pre-sale and after-sale service are important determinants of purchase decision.

(b) **Non-durable Goods :** Non-durable goods are products that are normally consumed in one go or last for a few uses. Examples of such products are soap, salt, pickles, sauce etc. These items are consumed quickly and we purchase these goods more often. Such items are generally made available by the producer through large number of convenient retail outlets. Profit margins on such items are usually kept low and heavy advertising is done to attract people towards their trial and use.

3. Based on tangibility, the products can be classified as:

(a) **Tangible Goods :** Most goods, whether these are consumer goods or industrial goods and whether these are durable or non-durable, fall in this category as they have a physical form, that can be touched and seen. Thus, all items like groceries, cars, raw-materials, machinery etc. fall in the category of tangible goods.

(b) **Intangible Goods :** Intangible goods refer to services provided to the individual consumers or to the organisational buyers (industrial, commercial, institutional, government etc.). Services are essentially intangible activities which provide want or need satisfaction. Medical treatment, postal, banking and insurance services etc., all fall in this category.



20.4 COMPONENTS OF PRODUCT MIX

In order to optimise the product requirements by the consumers, importance should be given to the following elements or components of product mix :

1. **Branding :** It is the process of using a name, sign, symbol or design to a product. A brand is an identification of a product. The part of the brand which can be spoken is called the brand name e.g., Detol, Nike etc. The part of brand which

cannot be spoken but can be recognised is the brand mark. e.g. arrow sign of Nike, star of Mercedz etc. A brand that is given legal protection against its use by other firms is called trade mark. e.g., is the trade mark of State Bank of India.

Customers demand the product by calling its brand name. For e.g. give one Lux, one Coke etc. Thus, it helps in product differentiation. Branding help companies to adopt differential pricing for its product. Customers are ready to accept that price because of its quality. Companies which use their brand name find it easy to market a new product.

2. **Packaging :** It is the act of designing and producing appropriate container or cover for the product.

   Level of Packing : There are three levels of packaging. These are:

   i. ***Primary Package :*** It refers to immediate packing of product. e.g., tube of ointment.

   ii. ***Secondary Package :*** It refers to additional packaging which gives protection to the product. e.g., Cardboard box used to keep ointment tube. Such containers and boxes are dispensed units where we start using the inside material from the primary package.

   iii. ***Transportation Packaging or Final Packaging :*** It refers to further packaging components necessary for storage or transportation. e.g., boxes of ointments are transported in corrugated boxes each containing 50/100 items.

   Packaging protects the product from damage. It helps to identify a product. It enables convenient handling of the product. As package increases the sale of a product, it acts as a silent salesman.

3. **Labeling :** Label is a part on the cover of the product which will devote its name, contents, ownership, expiry date, manufacturing date etc. A label helps in identifying the product. It is full of information about the product. It helps in grading the product. It attracts customers because of its colourful packing.

INTEXT QUESTIONS 20.2

1. Classify the following products into consumer goods and industrial goods and further classify them into convenience goods, shopping goods and speciality goods, if they are consumer goods :

   (a) Stationery for the office (b) Washing machine for use at home

   (c) A car for the family use (d) Oil for manufacturing soap

   (e) A pair of shoes for yourself

(f) An electric lift for lifting weight in the workshop

(g) A packet of biscuits for your breakfast

2. For the following categories of goods, give two examples of each, from the products that you see around you :

(a) Intangible goods (b) Durable goods (c) Non-durable goods

3. (a) The following words refers to tangible and intangible products. You are required to put these products into their right class in the appropriate boxes.

(i) Cricket Bat (ii) Ball (iii) Boarding a bus

(iv) 'Pollution check' (v) Pen

(vi) Getting medical advice from a Doctor

Tangible [ ] Intangible

(b) The following is a list of durable and non durable consumer goods. You are required to put them in the appropriate boxes.

(i) Refrigerator	(ii) Salt
(iii) Soap	(iv) Washing Machine
(v) Television	(vi) Cooking oil
(vii) Sauce	(viii) Note Book

Durable [ ] Non-Durable [ ]

20.5 PRICING AND FACTORS AFFECTING PRICING DECISIONS

As stated earlier price is the consideration in terms of money paid by consumers for the bundle of benefits he/she derives by using the product/ service. In simple terms, it is the exchange value of goods and services in terms of money. Pricing (determination of price to be charged) is another important element of marketing mix and it plays a crucial role in the success of a product in the market. If the price fixed is high, it is likely to have an adverse effect on the sales volume. If, on the other hand, it is too low, it will adversely affect the profitability. Hence, it has to be fixed after taking various aspects into consideration. The factors usually taken into account while determining the price of a product can be broadly described as follows:

(a) **Cost :** No business can survive unless it covers its cost of production and distribution. In large number of products, the retail prices are determined by adding a reasonable profit margin to the cost. Higher the cost, higher is likely to be the price, lower the cost lower the price.

(b) **Demand :** Demand also affects the price in a big way. When there is limited supply of a product and the demand is high, people buy even if high prices are charged by the producer. But how high the price would be is dependent upon prospective buyers' capacity and willingness to pay and their preference for the product. In this context, price elasticity, i.e. responsiveness of demand to changes in price should also be kept in view.

(c) **Competition :** The price charged by the competitor for similar product is an important determinant of price. A marketeer would not like to charge a price higher than the competitor for fear of losing customers. Also, he may avoid charging a price lower than the competitor. Because it may result in price war which we have recently seen in the case of soft drinks, washing powder, mobile phone etc.

(d) **Marketing Objectives :** A firm may have different marketing objectives such as maximisation of profit, maximisation of sales, bigger market share, survival in the market and so on. The prices have to be determined accordingly. For example, if the objective is to maximise sales or have a bigger market share, a low price will be fixed. Recently one brand of washing powder slashed its prices to half, to grab a bigger share of the market.

(e) **Government Regulation :** Prices of some essential products are regulated by the government under the Essential Commodities Act. For example, prior to liberalisation of the economy, cement and steel prices were decided by the government. Hence, it is essential that the existing statutory limits, if any, are also kept in view while determining the prices of products by the producers.

20.6 METHODS OF PRICE FIXATION

Methods of fixing the price can be broadly divided into the following categories.

1. **Cost Based Pricing :** Under this method, price of the product is fixed by adding the amount of desired profit margin to the cost of the product. If a particular soap costs the marketeer Rs. 8 and he desires a profit of 25%, the price of the soap is fixed at Rs 8 + (8x25/100) =Rs. 10. While calculating the price in this way, all costs (variable as well as fixed) incurred in manufacturing the product are taken into consideration.

2. **Competition Based Pricing :** In case of products where market is highly competitive and there is negligible difference in quality of competing brands, price is usually fixed closer to the price of the competing brands. It is called 'young rate pricing' and is a very convenient method because the marketeers do not have to worry much about demand and cost and effect the change as per the changes by the industry leaders.

3. **Demand Based Pricing :** At times, prices are determined by the demand for the product. Under this method, without paying much attention to cost and competitors prices, the marketeers try to ascertain the demand for the product. If the demand is high they decide to take advantage and fix a high price. If the demand is low, they fix low prices for their product. At times they resort to differential prices and charge different prices from different groups of customers depending upon their perceived values and capacity to pay. Take the case of cinema halls where the rates of tickets differ for the different sets of rows in the hall.

4. **Objective Based Pricing :** This method is applicable to introduction of new (innovative) products. If, at the introductory stage of the products, the organisation wishes to penetrate the market i.e., to capture large parts of the market and discourage the prospective competitors to enter into the fray, it fixes a low price. Alternatively, the organisation may decide to skim the market i.e., to earn high profit by taking advantage of a group of customers who give more importance to their status or distinction and are willing to pay even a higher price for it. In such a situation they fix quite high price at the introductory stage of their product and market it to only those customers who can afford it.

INTEXT QUESTIONS 20.3

1. List the main factors affecting pricing decision of a firm.
2. Which method of price fixation is being referred to here :
   (a) Hari fixes the price of shirts that he manufactures and sells at a price 10% higher than its cost.
   (b) Mannat introduces a new brand of biscuits at a low introductory price.
   (c) Sheetal fixes the price of her glassware keeping in mind the prices for similar products in the nearby shops.
   (d) Rahul, a fruit-seller increases the price of mangoes if there is a heavy demand for them during the summer season.
   (e) Pinky charges a high price for the exclusive designer handkerchiefs that she designs for a selective group of customers.

(f) Jahanavi lowers the price of the vegetables at her shop in the evening, so that customers purchase them even when they are not as fresh as they were in the morning time.

20.7 CHANNELS OF DISTRIBUTION

You are aware that while a manufacturer of a product is located at one place, its consumers are located at innumerable places spread all over the country or the world. The manufacturer has to ensure the availability of his goods to the consumers at convenient points for their purchase. He may do so directly or, as stated earlier, through a chain of middlemen like distributors, wholesalers and retailers. The path or route adopted by him for the purpose is known as channel of distribution. A channel of distribution thus, refers to the pathway used by the manufacturer for transfer of the ownership of goods and its physical transfer to the consumers and the user/buyers (industrial buyers).

Stanton has also defined it as "A distribution channel consists of the set of people and firms involved in the transfer of title to a product as the product moves from producer to ultimate consumer or business user". Basically it refers to the vital links connecting the manufacturers and producers and the ultimate consumers/users. It includes both the producer and the end user and also the middlemen/agents engaged in the process of transfer of title of goods.

Primarily a channel of distribution performs the following functions:

(a) It helps in establishing a regular contact with the customers and provides them the necessary information relating to the goods.

(b) It provides the facility for inspection of goods by the consumers at convenient points to make their choice.

(c) It facilitates the transfer of ownership as well as the delivery of goods.

(d) It helps in financing by giving credit facility.

(e) It assists the provision of after sales services, if necessary.

(f) It assumes all risks connected with the carrying out the distribution function.

Types of Channels of Distribution

Generally we do not buy goods directly from the producers. The producers/ manufacturers usually use services of one or more middlemen to supply their goods to the consumers. But sometimes, they do have direct contact with the customers with no middlemen in between them. This is true more for industrial goods where the customers are highly knowledgeable and their individual purchases are large. The various channels used for distribution of consumer goods can be described as follows:

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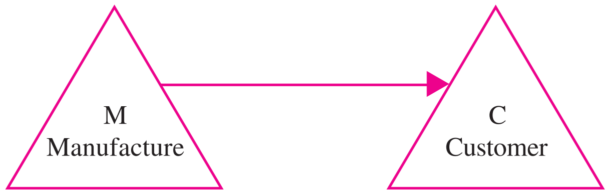
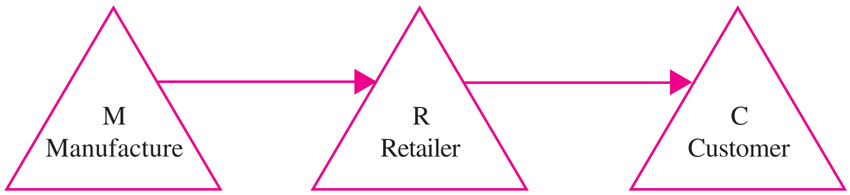
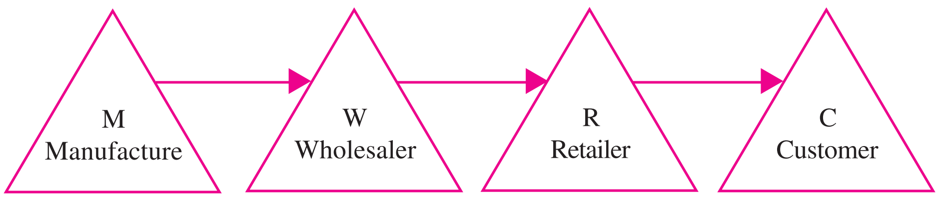
(a) Zero Stage Channel of Distribution : Zero stage distribution channel exists where there is direct sale of goods by the producer to the consumer. This direct contact with the consumer can be made through door-to-door salesmen, own retail outlets or even through direct mail. Also in case of perishable products and certain technical household products, door-to-door sale is an easier way of convincing consumer to make a purchase. Eureka Forbes, for example, sells its water purifiers directly through their own sales staff.



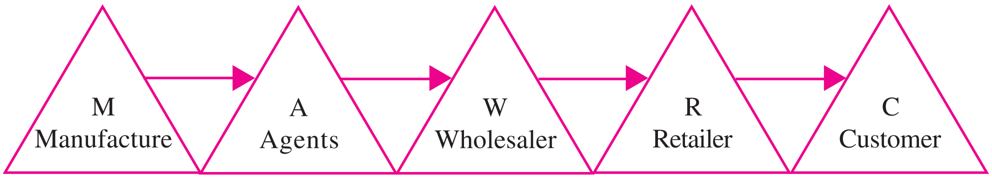
(b) One Stage Channel of Distribution : In this case, there is one middleman i.e., the retailer. The manufacturers sell their goods to retailers who in turn sell it to the consumers. This type of distribution channel is preferred by manufacturers of consumer durables like refrigerator, air conditioner, washing machine, etc. where individual purchase involves large amount. It is also used for distribution through large scale retailers such as departmental stores (Big Bazaar, Spensors) and super markets.



(c) Two Stage Channel of Distribution : This is the most commonly used channel of distribution for the sale of consumer goods. In this case, there are two middlemen used, namely, wholesaler and retailer. This is applicable to products where markets are spread over a large area, value of individual purchase is small and the frequency of purchase is high.



(d) Three Stage Channel of Distribution : When the number of wholesalers used is large and they are scattered throughout the country, the manufacturers often use the services of mercantile agents who act as a link between the producer and the wholesaler. They are also known as distributors.



INTEXT QUESTIONS 20.4

1. Give any four important functions performed by a channel of distribution.

2. Which type of channel of distribution will be suitable in each of the following cases? Name it and draw a labelled diagram (in the space given below) depicting the channel.

   (a) For a perishable product

   (b) Where large number of wholesalers are involved and are scattered throughout the country.

   (c) For durable products like washing machines.

20.8 FACTORS AFFECTING THE CHOICE OF DISTRIBUTION CHANNEL

Choice of an appropriate distribution channel is very important as the pricing as well as promotion strategy are dependent upon the distribution channel selected. Not only that, the route which the product follows in its journey from the manufacturer to the consumer also involves certain costs. This in turn, affects not only the price of the product but also the profits. Choice of inappropriate channels of distribution may result in lesser profits for the manufacturer and higher price from the consumer. Hence, the manufacturer has to be careful while finalising the channel of distribution to be used. He should pay attention to the following factors while making his choice.

(a) Nature of Market : There are many aspects of market which determine the choice of channel of distribution. Say for example, where the number of buyers is limited, they are concentrated at few locations and their individual purchases are large as is the case with industrial buyers, direct sale may be the most preferred choice. But in case where number of buyers is large with small individual purchase and they are scattered, then need may arise for use of middlemen.

(b) **Nature of Product :** Nature of the product considerably affects the choice of channel of distribution. In case the product is of technical nature involving a good amount of pre-sale and after sale services, the sale is generally done through retailers without involving the wholesalers. But in most of the consumer goods having small value, bought frequently in small quantities, a long channel involving agents, wholesalers and retailers is used as the goods need to be stored at convenient locations. Items like toiletries, groceries, etc. fall in this category. As against this in case of items like industrial machinery, having large value and involving specialised technical service and long negotiation period, direct sale is preferred.

(c) **Nature of the Company :** A firm having enough financial resources can afford to have its own distribution force and retail outlet, both. But most business firms prefer not to create their own distribution channel and concentrate on manufacturing. The firms who wish to control the distribution network prefer a shorter channel.

(d) **Middlemen Consideration :** If right kind of middlemen having the necessary experience, contacts, financial strength and integrity are available, their use is preferred as they can ensure success of newly introduced products. Cost factors also have to be kept in view as all middlemen add their own margin of profit to the price of the products. But from experience it is learnt that where the volume of sales are adequate, the use of middlemen is often found economical and less cumbersome as against direct sale.

20.9 PROMOTION

Promotion refers to the process of informing and persuading the consumers to buy certain product. By using this process, the marketeers convey persuasive message and information to its potential customers. The main objective of promotion is to seek buyers' attention towards the product with a view to:

- arouse his interest in the product;
- inform him about its availability; and
- inform him as to how is it different from others.

It is thus a persuasive communication and also serves as a reminder. A firm uses different tools for its promotional activities which are as follows :

- Advertising
- Publicity
- Personal selling
- Sales promotion

These are also termed as four elements of a **promotion mix**. Let us have a brief idea about these promotion tools.

1. **Advertising :** Advertising is the most commonly used tool for informing the present and prospective consumers about the product, its quality, features, availability, etc. It is a paid form of non-personal communication through different media about a product, idea, a service or an organisation by an identified sponsor. It can be done through print media like newspaper, magazines, billboards, electronic media like radio, television, etc. It is a very flexible and comparatively low cost tool of promotion.

2. **Publicity :** This is a non-paid process of generating wide range of communication to contribute a favourable attitude towards the product and the organisation. You may have seen articles in newspapers about an organisation, its products and policies. The other tools of publicity are press conference, publication and news in the electronic media etc. It is published or broadcasted without charging any money from the firm. Marketeers often spend a lot of time and effort in getting news items placed in the media for creation of a favourable image of the company and its products.

3. **Personal selling :** You must have come across representatives of different companies knocking at your door and persuading you to buy their product. It is a direct presentation of the product to the consumers or prospective buyers. It refers to the use of salespersons to persuade the buyers to act favourably and buy the product. It is most effective promotional tool in case of industrial goods.

4. **Sales promotion :** This refers to short-term and temporary incentives to purchase or induce trials of new goods. The tool include contests, games, gifts, trade shows, discounts, etc. Sales promotional activities are often carried out at retail levels.

INTEXT QUESTIONS 20.5

1. What are the main objectives of promotion? List them.

2. State the main factors affecting the choice of distribution channels.

3. Which element of the promotion mix is being referred to in the following statements.

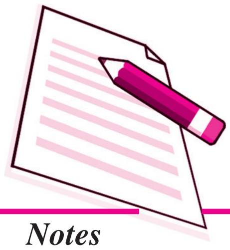
   (a) It is a temporary incentive to induce trial or purchase of a new product.

   (b) It does not cost money but may involve considerable time and effort by the marketeer.

   (c) It is an effective promotion tool for machines, lubricant etc.

   (d) Press conference, publications and news in the electronic media are its various tools.

   (e) It is a paid form of non-personal communication by an identified sponsor.



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(f) It is done through popular media like radio, television, magazines, newspapers etc.

4. Multiple Choice Questions :

i. To which tool of marketing mix does 'Brand Name' relate?

a) Product b) Price

c) Place d) Promotion

ii. Identity the philosophy in management which suggests that aggressive selling and promotional efforts are needed to sell product.

a) Production concept b) Product concept

c) Sales concept d) Societal concept

iii. A cool drinks manufacturing company is using chemicals to make its product (cool drinks), name the marketing philosophy which is ignored here.

a) Production concept b) Product concept

c) Sales concept d) Societal concept

WHAT YOU HAVE LEARNT

- The mix of product, price, place (distribution) and promotional efforts is known as 'Marketing Mix'.
- Product is defined as anything that can be offered to a market to satisfy a want. It not only includes physical objects and services but also the supporting services like packaging, installation, after sales services etc.

1. Based on use, products can be classified as

(a) **Consumers goods** meant for personal consumption by the households or ultimate consumers. Based on buying behaviour of consumers, they can be further classified as (i) Convenience goods; (ii) Shopping goods; and (c) Speciality goods.

(b) **Industrial goods** are meant for consumption or use as inputs in production of other products or provision of some service.

2. Based on **durability,** products can be classified as

(a) Durable goods; and (b) Non-durable goods.

3. Based on **tangibility,** they are classified as

(a) Tangible goods, and (b) Intangible goods

- Price is the consideration in terms of money, paid by consumers for the bundle of benefits he/she derives from use of product/services. The factors determining price of a product are- cost, demand, competition marketing objectives and government regulation.

- The different methods of price fixation are :

  1. Cost based pricing : Price is fixed by adding a desired amount of profit margin to the cost of the product.
  2. Competition based pricing : Price is fixed keeping in mind the price of competing brands.
  3. Demand based pricing : Prices are determined by the demand for the product.
  4. Objective based pricing : Here prices for new (innovative) products are kept low. Where the organisation decides to skim the market, prices are kept high.

- Channels of distribution are a vital link between manufacturers/producers and the ultimate consumers/users. It includes the middlemen/agents engaged in the process of transfer of title of goods. It helps in establishing regular contact with customers, facility for inspection of goods, transfer of ownership and delivery, it helps in financing, provision of after sales services and it assumes all risks connected with the distribution function.

- The various channels used for distribution of consumer goods are :

  (a) Zero stage channel : Manufacturer → Consumers

  (b) One stage channel : Manufacturer → Retailer → Consumers

  (c) Two stage channel : Manufacturer → Wholesaler → Retailer → Consumers

  (d) Three stage channel :

  Manufacturer → Agent → Wholesaler → Retailer → Consumers

- Factor affecting choice of distribution channel :

  - Nature of market
  - Nature of product
  - Nature of the company
  - Middlemen consideration

- Promotion is an applied communication used by marketeers to convey persuasive messages and information between the firm and its potential customers.

The different tools used for promotional activities are :

1. **Advertising :** It is a paid form of non-personal communication through different media about a product, idea, service or organisation, by an identified sponsor.
2. **Publicity :** It is a non-paid process of generating wide range of communication to contribute a favourable attitude towards the product and the organisation.
3. **Personal selling :** It is a direct presentation of the product to the consumers or prospective buyers.
4. **Sales promotion :** It refers to short term and temporary incentives to purchase or induce trials of new goods. For example, games, contests, gifts and discounts.

- Production concept suggests to sell the product by producing inexpensive products.
- Product concept emphasises on production of quality products.
- Selling concept suggests to sell what is produced.
- Marketing concept insist of designing product according to the taste of customer. It helps to give customer satisfaction.
- Societal concept insist to consider social goal with customer satisfaction.
- Branding is the process of using a name, term, symbol or design to identify the product.
- Packaging includes all the activities which are involved in making a container and protecting a product.
- Labeling provide a detailed information about a product.
- Various elements of promotion are advertising, sales promotion, personal selling and publicity.
- Publicity is a non-paid communication which gives information about a product.

KEY TERMS

Marketing Mix	Consumer goods	Durable goods
Product	Convenience goods	Non-durable goods
Price	Shopping goods	Tangible goods
Place	Speciality goods	Intangible goods
Promotion	Industrial good	Advertising
Publicity	Personal selling	Sales promotion

TERMINAL EXERCISE

Very Short Answer Type Questions

1. Define the term 'Advertising'.
2. What is meant by the term 'product'?
3. Give two examples each of tangible products and intangible products.
4. What are speciality goods? Give one example.
5. Define the term 'promotion'.
6. What do you mean by labeling?
7. What is the purpose of packaging a product?
8. What is meant by the 'product concept of marketing'?

Short Answer Type Questions

9. What are 'convenience goods' and 'shopping goods'. Explain giving examples for each type.
10. Explain 'cost based pricing' and 'objective based pricing'.
11. State four functions performed by channel of distribution.
12. Describe the various factors affecting choice of distribution channels.
13. What are durable and non-durable goods? Give two examples of each of them.
14. Write short notes on the elements of promotion.
15. State the functions of packaging.

Long Answer Type Questions

16. What is meant by Marketing Mix? Describe the four components of marketing mix.
17. Describe the classification and sub-classification of products on the basis of their use.
18. Explain the four broad methods of price fixation of a product.
19. 'Promotion includes four main tools'. Explain each of these tools.
20. "Channels of distribution are a vital link between manufactures and consumers". Describe this statement with the help of diagrams by mentioning the four types of channels of distribution.
21. 'Developing the product according to customer needs is an important concept of marketing management'. Explain briefly.
22. Differentiate between Publicity and Advertising.
23. Explain briefly the components of product mix.
24. Critically examine the objections of advertisement.

ANSWERS TO INTEXT QUESTIONS

20.1

1. (a) Product (b) Price (c) Place (d) Promotion
2. (a) Price (b) Place (c) Marketing mix
   (d) Product (e) Promotion

20.2

1. (a) Industrial goods
   (b) Consumer goods- shopping goods
   (c) Consumer goods - speciality goods
   (d) Industrial goods
   (e) Consumer goods - shopping goods
   (f) Industrial goods
   (g) Consumer goods - convenience goods
2. (a) banking, insurance or any other suitable example
   (b) car, washing machine or any other suitable example
   (c) salt, pickles, soap or any other suitable example
3. (a)

Tangible	**Intangible**
(i) Cricket bat	(iii) Boarding a bus
(ii) Ball	(iv) Pollution check
(v) Pen	(vi) Getting medical advice from a doctor

   (b)

Durable	**Non-durable**
(i) Refrigerator	(ii) Salt
(iv) Washing machine	(iii) Soap
(v) Television	(vi) Cooking oil
(vii) Sauce	
(viii) Note book	

20.3

1. (a) Cost (b) Demand (c) Competition
   (d) Marketing objectives (e) Government regulation
2. (a) Cost based pricing (b) Objective based pricing
   (c) Competition based pricing (d) Demand based pricing
   (e) Objective based pricing (f) Demand based pricing

Notes

20.4 2. (a) Zero stage channel of distribution

(b) Three stage channel of distribution

(c) One stage channel of distribution

20.5 1. (a) arouse buyer's interest in the product

(b) inform buyer about its availability

(c) inform him/her how it is different from other products

2. (a) Nature of market (c) Nature of product

(b) Nature of the company (d) Middlemen consideration

3. (a) Sales promotion (d) Publicity

(b) Publicity (e) Advertising

(c) Personal Selling (f) Advertising

4. (i) a (ii) c (iii) d

DO AND LEARN

Make a list of atleast five different types of products. Classify them into the product categories that you have studied (viz. consumer goods, industrial goods, durable and non-durable, tangible and intangible goods)

Find out about the type of channel of distribution that is used for these five products. Also, find out about the promotional activities that generally associated with the products.

Note your findings and tabulate them as follows :

Name of the product	*Product category According to (a) use (b) durability and (c) tangibility*	*Type of channel of distribution used*	*Promotional activities*

ROLE PLAY

Mani and Prasad are good friends. Mani is a marketing executive working for an MNC and Prasad is a small scale businessman making plastic toys:

Mani : Hi Prasad! How are you?

Prasad : Hello ! Mani, nice to see you.

Mani : How you business going on?

Prasad : Not very well.

Mani : Why?

Prasad : For the past 3 years my sales turnover has not increased. It is quite disturbing.

Mani : I understand, but tell me how is your distribution of the product done.

Prasad : I sell the toys in the local market and in the nearby town. I have a dealer. Thats it.

Mani : No, you have to analyse your distribution channel. Let us sit down and do some work. I think you should have at least three channels of distribution.

Prasad : Why?

Play the role of Mani and explain to Prasad the three suitable channels he should adopt for the plastic toys.

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21

ADVERTISING AND SALESMANSHIP

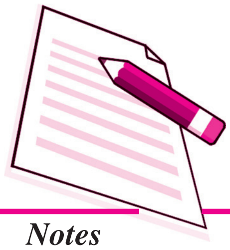
In TV, radio, cinema hall, newspapers and magazines, you observe a number of advertisements. These advertisement relate to a variety of products ranging from daily use items like oil, soap, shampoo, clothes to durable goods like television., refrigerator, automobile etc. For each product, a number of companies advertise their brand, as in case of washing powder, Surf, Ariel, Wheel, Doctor, Nirma etc, and in case of television, Videocon, Sony, BPL, LG etc.

The main purpose of advertising is to inform the prospective customers about the availability, quality, price etc. of the products and motivate them to buy. Besides advertising, sales promotion and personal selling are the other tools commonly used by the firms for promotion of their products. In this lesson, we shall learn about all these elements of the promotion mix.

OBJECTIVES

After studying this lesson, you will be able to:

- define advertising;
- differentiate between 'Advertising' and 'Publicity';
- explain the objectives of advertising;
- describe the advantages and limitations of Advertising;
- identify the various advertising media and their suitability;
- explain the meaning and importance of personal selling;
- state the qualities of a good salesman;
- describe the meaning and objectives of sales promotion and
- identify the various tools used in sales promotion.



Notes

21.1 ADVERTISING

While watching a movie in the cinema hall or a television at home you must have noticed that suddenly there is a break and a model appears on the screen displaying a product, indicating its special features, prices etc. This is followed by similar appearances relating to other products before the movie is resumed. These displays are known as advertisements which are used by different firms to inform a targeted group of customers about their product, its quality, availability, price etc. Likewise, you come across a number of advertisements for a variety of products in the newspapers and magazines. These are impersonal messages duly paid for, by firms to an audience who may be the current or prospective buyer of goods.

According to American Marketing Association "Advertising is any paid form of non-personal presentation and promotion of ideas, goods and services by an identified sponsor."

Thus, advertising is

(i) **Paid form of Communication :** Advertisements appearing in the newspapers, television, cinema halls etc. are duly paid for. The firms have to pay huge amounts for use of space in newspaper or time slot in television and radio etc.

(ii) **Non-personal Presentation of Message :** In advertisements there is no face to face communication as it happens in case of personal selling. These are presentations through mass media and as such are impersonal in nature.

(iii) **The Idea is to Promote Goods or Services :** Advertising is done with a specific objective of promoting a product or service and increase their sale.

(iv) **Issued by an Identified Sponsor :** The advertisers who sponsor the advertisement are duly identifiable in the advertised messages. Take the case of advertisement of Lifebuoy soap on TV wherein the name and symbol of HUL also appears.

Product	*Sponsor*	*Media*
Lifebuoy	Hindustan Unilever Ltd.	TV/Radio/Newspaper
Chyawanprash	Dabur India Ltd.	TV/Newspaper
Tide	Proctor & Gamble	TV/Newspaper

21.1.1 Publicity

Publicity is like advertising. But it is the news carried in the mass media about a product or about an organisation. But money is not paid for it publicity. Publicity can be positive or negative. Maggi Ketch-up and Maggi Masala gained popularity due to favourable publicity about Maggi Noodles. But there was substantial decline in the sales of chinese plastic toys after news reports of harmful materials in the plastic toys.

So we can say publicity is a powerful tool of communication as it can make or break a product/company.

21.1.2 Distinction between Advertising and Publicity

Advertising is different from publicity which is a communication of any significant information about a company or its product to the public through non-personal media without any payment by the concerned business firm. Thus, publicity is basically an information about the product, service or a business firm which is communicated voluntarily by the media and is of commercial significance to the firm. The information may be passed through media like magazines, newspapers, radio, T.V. in the form of debates, discussions, news items, reports, editorials etc. The company does not pay anything to the media for such activities. Look at the following.

1. While reading the newspaper you may get a news about an ongoing trade fair in your state. It talks about the products of different companies exhibited there. After reading this news item you may feel interested in having a look at or buying one or more of these products.

2. In a newspaper there may be a column on review of movies. You read the ratings given to different movies by a critics and at times, feel interested in watching a particular movie.

3. In the television news, sometimes we get information about the quarterly financial results of companies. This may motivate us to buy shares of such companies.

In all the above instances there is information about the product or services or the firm which is communicated through print or electronic media, leading to significant responses by the public. Can it be called advertising? But, these are non-sponsored and have not been paid for. As such, these are instances of publicity, and not advertising.

Difference between Advertising and Publicity

	Advertising	*Publicity*
1. Payment	It is a paid form of dissemination of information. The firm has to pay for the use of space and time.	The sponsor does not make any payment to the media as the information is published/ communicated voluntarily.
2. Identified Sponsor	There is an identified sponsor, that is, the business firm which wants to advertise it's products or services.	There is no identified sponsor. Media communicates the information as it considers it newsworthy.

Notes

3. Control	The advertising firm has full control over the content, type, size, duration and frequency of the message.	The concerned firm has no control over the contents, type, and size of the information.
4. Purpose	It is intended to give favourable and positive impression about the company and its products.	This may have favourable or unfavourable impression on the public about the company and its products.

21.1.3 Objectives of Advertising

The main objective of advertising is to help a business firm to promote its products and increase the sales. But, there are some other goals also which a firm can achieve with the help of advertising. The objectives to be achieved through advertising are as follows:

1. **Introduction of new product :** Business firms keep on introducing new products in the market and have to inform the prospective customers about its features, price, usage, availability etc. Advertising not only attracts their attention but also helps them in forming an opinion about the product and making the best purchase decisions.

2. **Increase in sale :** Advertising helps in increasing the sale of firm's products. It also helps in turning non-users of products to users of products and also in attracting the consumers of competitor's products. Business firms make use of advertising to inform the consumers about the advantages and superiority of their product.

3. **Maintaining existing buyers :** Now-a-days new products keep on entering in the market at a fast pace and consumers tend to switch over to the new products. Advertising is used to remind the consumers about how good their products or services are and that they are still in the market as old and reliable ones. The idea is to prevent decline in the sale of their product in the market.

4. **Create and enhance goodwill of the firm :** Advertising helps in building reputation of the business house. Through advertising, the firms can communicate their achievements to the consumers and clarify any misconceptions or doubts in the mind of the public about themselves or their products, if any. This helps in creating a good image of their firm in the minds of consumers, workers, investors, government and so on.

5. **Dealer support :** Another objective of advertisement is to provide the necessary support to firm's dealers and distributors. Hence some advertisements, besides the information about the product characteristics, price etc., include a list of dealers and distributors.

6. **Create and enhance brand image :** Advertising is also used for creating a brand image which helps in building customers' loyalty. When customers develop brand loyalty, they do not shift to other brands easily. Brand image gets enhanced with repeated advertisements.

7. **Helps in personal selling :** Advertising facilitates the process of personal selling. The salesperson's job is made easier if the customer has familiarity with the product. This is achieved through advertising. A customer is more receptive to the salesperson if he/she already has some idea about the product.

INTEXT QUESTIONS 21.1

1. The following sentences give the characteristics of advertising and publicity. You are required to put 'A' for characteristics of advertisement and 'P' for publicity in the boxes given against each sentence.
   (a) It is paid form of dissemination of information. ☐
   (b) There is no identified sponsor. ☐
   (c) There is an identified sponsor. ☐
   (d) This may leave favourable or unfavourable impression on the public about the company and its products. ☐

2. Read the following and indicate which objective of advertising is the company trying to achieve.
   (a) A washing powder manufacturing company issuing an advertisement about protection of the girl child.
   (b) A consumer durables company bringing out an advertisement giving a list of dealers selling its products.
   (c) A company using a celebrity to advertise their product.
   (d) A company manufacturing technical products issuing an advertisement showing use and operation of its products.

21.1.4 Advantages of Advertising

In today's competitive world there are innumerable products competing with each other. Hence, it is necessary that information regarding features, prices and availability of the product is frequently communicated to the consumers so as to ensure a reasonable market share for the manufacturer. Not only that, it also helps the consumers to make a right choice. So, advertising today benefits not only the business houses who manufacture the products but also the consumers and society. Let us now have a brief idea about how advertising benefits the manufacturers, consumers and the society.

Notes

Benefits to Manufacturers

Advertising helps the manufacturers in introducing new products, maintaining customers of existing products and in increasing their sales by attracting new customers. It also helps the business houses in creating and enhancing their goodwill. It makes the job of salespersons easier by keeping the customer informed about the product. Advertising is an important tool for fighting competition in the market effectively by giving the customers a comparative picture of its products vis-a-vis the competitors' products.

Benefits to Consumers

Advertising helps the consumers to gain useful information about the products, prices quality, terms of sale, after sales services, etc. Besides providing such information advertising also guides the customers about the right use of the product. This helps them to make a comparative analysis and make their choice. Not only that, advertising is the main source of information for those who live in remote areas and cannot be easily approached by salespersons.

Benefit to Society

The enhanced competition resulting from advertising motivate the producers to make improvements in their existing products and find out better alternatives through Research and Development (R&D) activity. So it helps in providing more convenience, comfort, better life style to the people. Advertising also works as a guide and teacher for people who do not know about many products and their multiple uses, if any. It generates employment for thousands of people who are connected with advertising world in different capacities. Not only that, advertising generates huge revenue for both print and electronic media. This helps the availability of newspapers, magazines and television programmes at affordable prices.

21.1.5 Limitations of Advertising

Many people consider advertising to be a wasteful activity and something harmful for the customers and the society in many ways. Their arguments against advertisement are as follows:

(i) **Advertising multiplies wants :** People tend to desire and buy products as they see in advertisement even if they do not actually need or afford them. This multiplication of wants may put them under financial and psychological pressure.

(ii) **Advertising adds to the cost and price of product :** Money spent on advertising eventually results in increased cost of the product, which is passed on to the consumers through increased prices. You must have noticed that the brands which are advertised heavily in different media are found to be priced higher as compared to those which are not so heavily advertised.

(iii) Creation of monopoly : Business firms which can spend heavily on advertising are usually the ones who grab a bigger share of the market. Such firms generally have a monopoly which results in unequal opportunity for small producers to make a place for themselves in the market. They do not get a fair opportunity to compete.

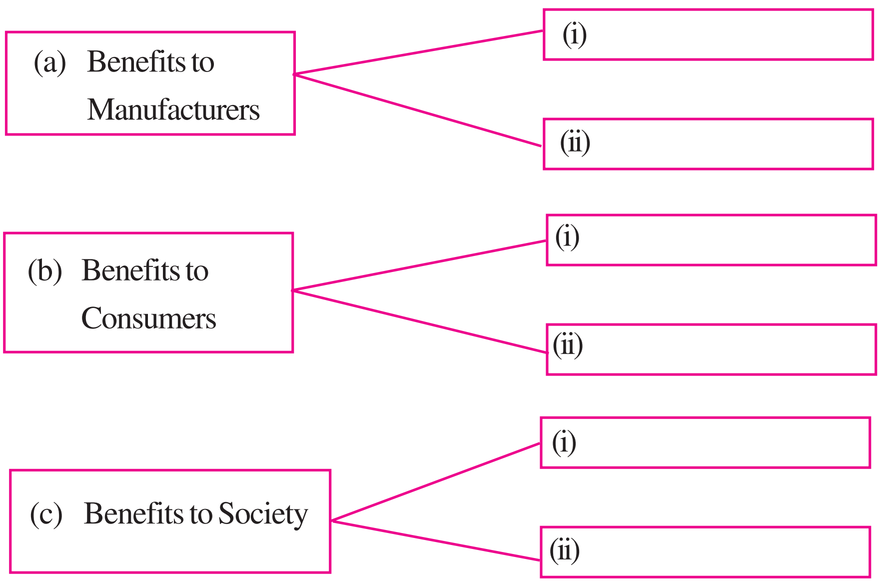
(iv) Advertising may affect the value-system of society : Advertising may introduce ideas or concepts alien to our culture. These new values generated or propagated by advertising may affect our social, moral and ethical values adversely. Objectionable appeals like sex, horror etc. are sometimes used in advertisement to attract attention.

(v) Motivation for wrong or dangerous deeds : The way advertisements project people consuming liquor, cigarettes or pan-masala, may feel tempted by the people to try and then get addicted to such products which are not good for health. Similarly, models are shown doing dangerous acts like jumping from the top of a hill which some children may try to copy and may face the accidents.

(vi) Advertising may not increase overall demand : Advertising does not always increase demand. In many cases, a number of firms manufacturing similar products may advertise vigorously. This may not result in an increase in the total demand for the product but simply shift demand from one brand to another.

INTEXT QUESTIONS 21.2

1. In the flow charts given below, the benefits of advertisement are given under three heads. You are required to state two important points of benefit under each head.



2. State any four limitations of advertising.

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21.1.6 Media of Advertising

Advertising media are the means through which messages regarding products and services are transmitted from the advertising firm to people at whom that product is targeted. Many types of media are available for the purpose. These are enumerated below.

- **Newspapers :** Newspaper is a good means of advertising since a big proportion of our country's population read newspapers published in Hindi, English and the various regional languages.

  Newspaper is the most suitable media for advertising consumer products used by masses. Such products include durables like TV, Refrigerator, Cycle, Scooter, Washing Machine etc. and non-durables like soaps, shampoos, oils, etc. It is also suitable for advertising many services like banking, insurance, transportation, etc. However, it is not suitable for advertising products which have limited number of buyers like industrial products or products used by specific professionals like engineers, doctors etc. Similarly, there are very few buyers for products like art & crafts, expensive designer jewellery, furniture etc. For such products, advertising in the newspaper is not considered appropriate.

- **Television :** Television is an important source of entertainment. It shows varieties of programme in different channels and in different languages for 24 hours in most cases. Hence advertising of different products can be done on different channels during the day as well as night. It has the ability to attract the attention of different segments of consumers according to their viewership. For example, products used by children such as chocolates, school bags, chewing gums, toys, play school etc. can be advertised during programmes like cartoon network, story telling etc. Similarly, household products and cosmetics can be more effectively advertised during programmes watched by women in the family. It is a medium of advertising with a lot of flexibility and reach as visuals are more effective than audio and print media. It has the added advantage of reaching out to the illiterate consumers.

  Just like newspapers, this medium can be used for products of mass-use, like consumer durables, non-durables etc. But it cannot be used effectively and efficiently for specialised products meant for professionals or for industrial products. For introduction of new products, repeated advertising in television programmes is of immense help. However, the major limitation of this medium is the heavy cost. Hence, only large enterprises are in a position to use this media.

- **Radio :** Radio is the most common source of entertainment for rural masses and the people in the semi-urban areas. However, the addition of FM radio has brought back the lost importance of radio in urban areas. The radio programmes too have

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a lot of advertising before and during the programme. Krishi Sandesh programme (for farmers) for example has advertisements on pesticides, fertilizer, tractors etc. Advertising on radio is popular in India because a number of villages do not have electricity and television transmission facility. Hence radio still remains a popular medium of advertising for rural people. Like television, radio is also a source of entertainment, news and views. But, arrival of large number of channels on television has reduced the popularity of radio and consequently its use for advertising.

- **Magazines and Journals :** Magazines and Journals are the print media of advertising. These are published periodically i.e., weekly, fortnightly, monthly, quarterly, half yearly or annually. Their circulation is limited and most magazines are generally targeted at specific segment of readers. Hence, advertisers use this media selectively according to the target customers to be reached. For example, the health care products can be advertised in magazines like Health and Nutrition, sports goods in magazine like Sports Star, medicines and medical equipment in different medical journals and so on.

- **Films :** Films are an important source of entertainment in India and as such an important medium of advertisement. Advertisements are generally shown before the start of the show or during interval. It can be used for advertising products of mass consumption like cosmetics, toiletries, medicines, etc. People from all strata of society visit cinema halls. But with limited reach, this is a comparatively costly medium.

- **Outdoor Advertising :** While travelling by bus or train, you must have noticed a number of advertisements on the walls, billboards, outside and inside the buses and trains. Even while walking on the road you must have seen advertisement of different products, shops, schools, coaching institutes, written on the back of a scooters, rickshaws, and buses etc. These are examples of outdoor advertising which are usually in the form of hoardings, displays on walls of buildings, public places like railway station etc., and are generally used for advertising products like shoes, lotions, creams, fans, cycles etc. They are also done through electronic displays. Lights and neon signs are used during night at different places with advertisement messages illuminating at regular interval. Another media of advertisement in outdoor advertising is vehicular displays. The space outside buses, company trucks (used to carry own company's products) can be used to attract and inform the customers about the product, availability, price etc. It may be noted that the cost of hoardings/neon signs etc. is quite high due to heavy initial expenditure on their preparation and installation. The rent paid for locating these at public places is also quite high. Despite this, all outdoor media are less expensive as compared to print, television and radio advertising. However, their reach is highly limited.

Notes

INTEXT QUESTIONS 21.3

1. Complete the following table by writing the names of the products advertised most frequently in the given medium.

Medium	*Products Advertised*
Newspaper	1. 2. 3.
Television	1. 2. 3.
Radio	1. 2. 3.
Magazines	1. 2. 3.

2. Which medium/media of advertising will be most suitable in the following cases:

   (a) For advertising products of mass consumption for all strata of the society.

   (b) To reach a selective target group or a specific segment of readers.

   (c) To catch the attention of people at traffic lights, in traffic jams or when they are travelling by train.

   (d) To reach out to illiterate consumers as well as to use the visual medium effectively.

   (e) To reach a wide range of the literate population of the country.

   (f) For advertising to people in rural, semi-urban and the urban areas.

Notes

21.2 SALESMANSHIP

Once your friend had gone to a readymade garment shop to buy a pant for his younger brother. The salesperson showed him the latest collection of garments. By the time the process of sale concluded, he had also purchased one for him. The reason for such unplanned purchase was the effect of salesmanship. The salesperson at the counter first assessed his interest in the new fabric available and then persuaded him to buy it. This whole exercise of assessing our need, activating it and ultimately satisfying it by selling the product to us is termed as salesmanship or personal selling. It is a process of assisting and persuading the prospective customers to buy a product in a face-to-face situation. In other words, salesmanship simply means selling through personal communication. For successful selling the salesperson usually goes through a selling process which involves the following seven steps.

(i) Prospecting

↓

(ii) Pre approach

↓

(iii) Approach

↓

(iv) Presentation and demonstration

↓

(v) Answering the queries/objections and their clarification

↓

(vi) Action or ending the process of sale

↓

(vii) Follow up or after sales service

Prospecting refers to identifying the prospective buyers in his area of operation. Having done this, he has to obtain the necessary information about the customer, his capacity to pay, choice and preferences etc. After this, in pre-approach activity he approaches the customer to gain his attention, greet him and make his presentation i.e., inform the customer about the product, its qualities, price etc. and demonstrate its use, if required. Then he handles the customers queries, persuades him to make his final decision and ends the process of sale with receiving his order and thanking him. Finally he ensures the delivery of goods and provides the necessary after sales service.

21.2.1 Importance of Salesmanship

The flow of goods from the producers to the consumers may not be possible without the involvement of salespersons. The salespersons play an important role in the process of sale. Starting from the conversation with the consumer to effecting a sale they actually act as an important link between the manufacturer and the consumer. They ensure the sale of products and so also provide satisfaction to customers. Thus, it is not only the business houses which benefit from salesmanship but also the consumers and the society. The benefits of salesmanship are discussed below :

1. **Benefits to Consumers :** A salesperson acts as a friend and guide to the consumers. By making conversation with salesperson, the customer gets help in identifying the product of his need and the price range that suits him. The salesperson explains to the customers the uses and the operational aspects of a product. By giving the requisite information about the company and the product, the salesperson provides confidence to the customers to try something new which might be better and/or cheaper. The salesperson also provides the necessary after sales service to the customers.

2. **Benefits to the Business :** Salesmanship helps a business in increasing its sales. Identification of new customers and persuading them to buy can be done effectively through personal selling. Since the salesperson comes in direct contact with the customers, understands the needs and preferences of the customers and thus, can help the businessman in planning for the right type of products and effecting the necessary improvements therein.

   In case of products of technical nature the role of salesmanship is very important as the salesperson can personally explain the functioning of the product, its use and precaution to be taken in its use. This ensures proper handling of the product, and boosts customer's confidence in his choice of the products.

3. **Benefits to the Society :** Salesmanship facilitates the process of production, distribution and consumption. Salespersons help in collecting market information, credit information, delivering goods and collecting payments. It helps in matching demand with supply because they know what the consumers want. They also inform the consumers about the introduction of new products, if any. By increasing sales, they help in the growth of business.

21.2.2 Qualities of a Good Salesperson

In the market you find a number of shops selling the same product but you prefer to go to a particular shop only. Why? This happens primarily because of the way the staff of the shop attend to you. The salesperson at the counter welcomes you with a smile, shows keen interest in your purchase and explains about the different varieties of the product in such a way that it become easier for you to take a decision. So, besides the availability of the product, its price etc., it is the good salesmanship that makes a difference and builds your preference for a shop. Let us now understand the basic qualities which a salesperson must possess to be able to attract and retain a customer like you. Salesmanship is a tough and challenging job which requires a mixture of physical and mental qualities. Some of the common qualities which a salesperson must possess are as follows.

(a) **Good Personality :** Personality is a mixture of many traits like physical appearance, dressing-up, way of talking, manners, pitch of voice, habits etc. Personality of a salesperson should be such that the moment he/she comes in contact with the customer, he/she looks amiable with whom the customer is at least ready to start a conversation.

(b) **Mental Qualities :** A salesperson must have the quality of alertness, imagination, foresightedness, empathy etc. He should have the ability to read the customer's mind and behave accordingly. There may be certain doubts or apprehensions in the mind of the customer regarding the product. Only a salesperson with these mental qualities will be able to solve the customer's problems. A good salesperson should be able to match the product with the customer's need and ability to pay.

(c) **Good Behaviour :** A salesperson should be a well behaved person having ability to interact with people comfortably. He/she should be cooperative so that he/she can help people in making up their minds by patiently answering all their questions. Patience and humility will help him/her in not only holding the attention of the customer but also in getting them interested in purchasing the product.

(d) **Knowledge :** While buying a television set normally we ask the salesperson a number of questions about the features of the latest model. If the salesperson fails to answer our queries or if we are not satisfied with the reply, we may leave that shop and visit another shop where all of our queries are answered by the salespersons. This is possible only when the salesperson has detailed knowledge about the product. He/she should know every detail relating to the product and the company he/she is representing. He/she should be able to explain the various features of the product, the way it is to be used and the precautions to be taken and so on. Knowledge about competitors' product is also a must so that the salesperson can explain the superiority of his/her product.

(e) **Ability to communicate and persuade :** If a salesperson can communicate properly and effectively then he/she will be able to clear the biggest hurdle of making the prospective customer listen to him/her. The salesperson must speak confidently, clearly and audibly. Good communication ability coupled with good knowledge about the product helps the salesperson in persuading the customer to buy.

(f) **Persistence :** The salesperson must know the art of persistence. It requires a sense of determination to convince the customers to buy. He/she must not give up easily. Without being offensive, he/she must persuade the customer to finalise the purchase with a sense of satisfaction.

INTEXT QUESTIONS 21.4

1. Complete the flow chart

A

↓

Pre-approach

↓

Approach

B

↓

Answering the queries/objections and their clarification

↓

C

↓

After sales service

2. State briefly the benefits of salesmanship to:

   (a) Consumers

   (b) Business

   (c) Society

3. List any six qualities of a good salesperson.

21.3 SALES PROMOTION

In the market, sometimes we see the special offer like 'Buy one get one free offer'; on a particular brand of tea there was 50 gm. extra in a 250 gm pack or one glass or bowl free with 500 gm. pack. There are innumerable examples where the manufacturer or the seller tries to tempt you to buy his product by offering discounts, extra quantity or a chance to win grand prizes, etc. All such activities are known as sales promotion.

All promotional activities other than advertising, salesmanship and publicity which help in increasing the market demand of the product are called sales promotion. It is a non-repetitive and one time communication process. According to **American Marketing Association** "Sales Promotion includes those marketing activities, other than personal selling, advertising and publicity that stimulate consumer purchasing and dealer effectiveness such as displays, shows and exhibitions, documentation and various non-recurrent selling efforts not in the ordinary routine".

All elements of a promotion mix such as personal selling, advertising, publicity are used to inform people about the availability of a product, its characteristics and features and to create desire in the mind of the people to buy the product. Sales promotion is an effort in the same direction and is another important element of the promotion mix which includes displays, free sample, trade fairs, exhibitions, discount coupons, deferred payment plans, etc.

21.3.1 Objectives of Sales Promotion

Different sales promotional tools have different objectives. For example, while a free sample may motivate a consumer to buy a product for the first time, a free check-up for existing durable product like television, refrigerator etc. may affect future purchase decision of the buyer. Some of the objectives of sales promotion are listed below :

1. **Information to Customers :** Sales promotion activities inform the potential buyer about the availability, features, uses etc. of the product. Thus, it offers additional support to promotional activities like advertising, publicity and personal selling (salesmanship).

2. **Persuades Customers :** Sales Promotion activities aim at arousing customers' interest in the product and persuading them to buy.

3. **Increase in Sales Volume :** It aims at increasing sales. It is specially done during the periods when customer may not buy the product because it may not have immediate use, like a room cooler in winter, and a room heater in summer. The sales promotion schemes are a big help in making off-season sales and also in tempting the buyers to make quick decisions to purchase.

4. **Incentive to Retailers :** The main objective of sales promotional activities is to offer promotional support to retailers. Sales promotion schemes make sales easier. Incentive schemes help in getting shelf space for such products in new retail outlets.

5. **Create Product Identity :** A number of brands of a particular product are available in the market and it is very difficult to distinguish one from the other as all have similar features, prices, variety etc. Under sales promotion programme, product identity is established by offering additional features and incentives. This helps in building consumers' preference for the specific products and brands.

21.3.2 Difference Between Advertising and Sales Promotion

Basis	Advertising	Sales Promotion
(a) Objectives	Objectives of advertising is to to create a favourable consideration for the product.	The objective of sales promotion is to stimulate the consumers to buy the product.
(b) Effect	It has a long term effect.	It has a short term effect and useful for increasing immediate sales.
(c) Nature	Advertising is recurring in nature.	It is non-recurring and one time communication process.

21.3.3 Tools Used in Sales Promotion

Sometimes we get a small pack of tea, shampoo, soap or floor cleaner free from the manufacturer or producers. Have you ever thought why do companies distribute their products free like this? Because, their main intention is to attract the consumers' attention towards the product and then make them feel tempted to buy the product. This is a tool of sales promotion. Some of such promotional tools are given below:

1. **Distribution of Free Samples :** As mentioned above, distribution of free sample is a commonly used sales promotion tool. It is a good method for introducing a new product or a brand in the market. Such free samples can be distributed at the door step, through fairs, or even through retail stores.

2. **Bonus Offer :** At times marketers offer something extra with standard products without any additional charge to the customer. It could be extra quantity of the same product or some other product of the company like toothbrush with toothpaste or any other related items as gift like a bucket with large pack of washing powder, and so on.

3. **Price-off :** To increase sale, or to reduce competition, many business firms cut down prices. Prices may also be cut down during off season to maintain certain volume of sales.

4. **Exchange Offer :** Under this scheme, companies generally attract the customers by offering a price cut on purchase of new product in exchange for an old product. Recently you must have seen many advertisements talking about such offers on purchase of new refrigerator, television, washing machine, motorbike, cars, etc.

5. **Fairs and Exhibitions :** Trade fairs, exhibitions and fashion shows are important tools of sales promotion. They provide a forum for demonstration and exhibition

of products. A lot of important information about the product can be communicated to the customers through leaflets, brochures etc. during fairs and exhibitions. Especially in case of technical products like computer and electronic households gadgets, live demonstrations are undertaken. This cultivates customers' interest and boosts their confidence in the product.

6. **Free Offer :** Many companies give 'free' offers to boost the sales of their products. They offer products of similar or related nature with the purchase of main products. For example, VCR/VCD free with plasma TV is an example of such free offer.

7. **Money Refund Offer :** Of late, another method being used by marketeers to boost consumer's confidence in a product is a promise of total refund of money spent on the product if the buyer is not happy with the product's performance. Such offer not only arouses the customers' interest in the product but also motivates them to make a trial.

8. **Discount Coupon :** Discount Coupon is a certificate that entitles the holders a specified discount on purchase of a product. Such discount coupon may be issued by the company by mail or through the dealers. They can also be issued through newspapers.

9. **Deferred Payment Plan :** During 1980's, some of the airlines offered deferred payment plans - 'Travel today pay fare later' for air journeys for promoting travel. It was quite a success. This plan is quite common now-a-days in case of TVs and air-conditioners.

10. **Contests :** There may be a contest like quiz related to the product or slogan writing. In case of quizzes, the questions are generally prepared in a way that consumers feel forced to know about the company and the product in the hope of winning a prize. These contests can be held on television, radio and through the magazines.

Activity

While reading newspaper and watching television, note down the sales promotional tools being used by different companies. Give any five example of such tools in detail.

INTEXT QUESTIONS 21.5

1. State the main objectives of sales promotion.
2. Name the sales promotion tools being referred to here:

   (a) A sachet of a new brand of shampoo attached to a magazine for use by its readers.

(b) 10% talcum powder extra in a 250 gram tin.

(c) A crossword puzzle on information about a new magazine for children.

(d) A comb free with a bottle of hair oil.

(e) Books being sold at the annual book fair in your town.

(f) A ceiling fan being offered at a discounted price to customers during winters.

Notes

WHAT YOU HAVE LEARNT

- Advertising is 'any paid form of non-personal presentation and promotion of ideas, goods and services of an identified sponsor'.
- Publicity is a communication about the product, service or a business firm which is communicated voluntarily by the media and is of commercial significance to the firm.
- Objectives of Advertising: The main objectives of advertising is to help a business firm to promote its products and increase the sales. It helps in introducing new products in the market and maintains its current share of market. It creates and enhances goodwill of the firm and also provides support to dealers and distributors. It facilitates personal selling and enhances brand image of the firm.
- Advantages of Advertising: Advertising helps the manufacturers in introducing new products, maintaining the demand of the existing products and attracting new customers. The consumers gain useful information about products, quality, terms of sales etc. It helps them to make a comparative analysis and make their best choice.
- Advertising generates huge revenue, employment opportunities in the country. It increases competition and motivate the producers to produce better alternatives of the existing products by utilising the findings of research and development.
- Limitation of Advertising : It multiplies the wants of the consumers. It adds to the cost of the product which ultimately increases the sales price. It helps in creating monopoly in the market. In real sense it does not increase the overall demand but simply shifts the demand from one brand to other. Sometimes people feel tempted by seeing the advertisements and then get addicted to different harmful products. Advertising may also have advese effect on our social moral and ethical value.
- **Media of Advertising :** Newspapers; Television; Magazines and Journals; Films; Outdoor Advertising

- Personal selling is a process of assisting and persuading the prospective customers to buy a product in a face-to-face situation. It helps the consumers to make his/her best choice. It increases the sales of the product. It helps in collecting market information, credit information, delivering goods and collecting the payment.
- **Qualities of a good salesperson :** Good personality; Mental qualities like alertness, imagination, foresightedness, empathy etc.; Good behaviour; Knowledge about the product; Ability to communicate and persuade
- Sales promotion: All promotional activities other than advertising, salesmanship and publicity which help in increasing the market demand of the product.
- **Objectives of Sales promotion :** Inform the potential buyer; Persuades customers; Increase in sales volume; Incentive to retailers; Create product identity
- Tools used in sales promotion : The various commonly used tools are free samples, bonus offer, price off, exchange offer, fairs and exhibitions, free offer, money refund offer, discount coupon, deferred payment plan, contest etc.

KEY TERMS

Advertising	Bonus Offer	Discount Coupon
Films Advertising	Money Refund offer	Outdoor Advertising
Price-off	Publicity	Sales Promotion
Salesmanship	Sponsor	

TERMINAL EXERCISE

Very Short Answer Types Questions

1. Define the term advertising.
2. What is publicity?
3. Define personal selling.
4. State the meaning of Sales Promotion.
5. Explain ‘Bonus offer’ as a tool of sales promotion.

Short Answer Types Questions

6. What are the main objectives of advertising? Explain briefly.
7. How is publicity different from advertising?

Notes

8. Name four items each, which are best suited for advertisement in 'Magazines and Journals' and through 'Films'.

9. What are the limitations of advertising?

10. State the importance of personal selling for the society.

Long Answer Types Questions

11. "Advertising plays an important role in business and society". Discuss.

12. What is the right media for advertising consumer durable products ? Discuss.

13. A manufacturer of detergent powder wants to introduce detergent cake in the market under a new brand name. Which sales promotion tools should he use to attract the customers? Give reasons in support of your answer.

14. One reputed company wants to recruit salesmen for retail stores. Can you identify the qualities they should look for in the prospective candidates?

15. What are the objectives of Sales promotion? Explain in brief, giving a list of various popular sales promotion tools.

ANSWERS TO INTEXT QUESTIONS

21.1

1. (a) A (b) P (c) A (d) P

2. (a) Create and enhance goodwill of the firm
   (b) Dealer support
   (c) Create and enhance brand image
   (d) Helps personal selling

21.2

1. (a) Benefit to Manufactures
      (i) Introduction of new products
      (ii) Creating and enhancing goodwill

   (b) Benefits to Consumers
      (i) Information about product, prices etc.
      (ii) Guides the consumers about proper use

   (c) Benefits to society
      (i) Generates employment
      (ii) Generates huge revenue for print and electronic media

2. (a) Advertising multiplies wants
   (b) Advertising adds to the cost and prices of product.
   (c) Creation of Monopoly.
   (d) Motivates for wrong or dangerous deeds.

21.3 2. (a) Films Advertising (b) Magazines and Journals
(c) Outdoor advertising (d) Television
(e) Newspapers (f) Radio

21.4 1. (a) Prospecting (b) Presentation and demonstration
(c) Action or closing the sale

3. (a) Good personality (b) Mental qualities
(c) Good Behaviour (d)Knowledge
(e) Ability to communicate and persuade
(f) Persistence

21.5 1. (a) Information to customers (b) Persuades Customers
(c) Increase sales (d) Incentive to retailers
(e) Create product identify

2. (a) Distribution of free sample (b) Bonus offer
(c) Contests or Quizzes (d) Bonus-offer
(e) Fairs and exhibitions (f) Price-off

DO AND LEARN

1. Visit any two retail shops selling a particular kind of items (may be readymade garments or electronic goods) in your locality. Note down the different qualities of the salespersons you noticed during your conversation. Prepare a comparative chart and draw conclusion giving suitable reasons about the quality of salesmanship in both the retail shops.

2. Make a list of 10 different types of products. Find out the media used for their advertising. Also find out the different sales promotion tools being used by marketeers to promote that product. Tabulate your findings as shown below.

Name of Product Ball pen	*Advertising Media Newspapers, Television*	*Sales Promotion tools used Fairs and Exhibitions*
1.		
2.		
3.		
4.		
5.		
6.		

ROLE PLAY

Abhay Gupta has a small factory that manufactures biscuits and his friend Suryakant is a fresh MBA graduate. Both are discussing about promotion of Abhay's products.

Abhay : People hardly know about my brand of biscuits. How do I increase my sales?

Suryakant : Simple, Advertise your product.

Abhay : But advertising is an expensive option.

Suryakant : No, No. But you must make choice of the right media. You can advertise through your local cable channel on television initially and then through other popular television channels.

Abhay : Any other method to increase my sale.

Suryakant : Yes. Use promotional schemes; send people for door-to-door selling.

Abhay : All, this sounds a little difficult.

Two friends sat down and discussed various ways of promoting the products keeping in mind cost and return involved in advertising in different media, different kinds of sales promotion offers, salesmanship etc.

Continue the conversation between them, taking the role of Suryakant and asking your friend to play Abhay Gupta's role.

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22

INTERNAL TRADE

You may be using a variety of products in your daily life, right from a notebook, a pen, soap, garments, vegetables, fruits to radio, television, fans and furniture. Where do you buy all these products? Your answer will be – from the nearby market. Sometimes during special occasions like a festival or a marriage we prefer going to a market that may be located at a distance from our residence. Now the question that arises is, how do all these products reach the market? There are a number of firms/people who are involved in this activity of bringing the product from the place of production to the market and then making it available to the ultimate consumers. They act as a link or bridge between the producers and the consumers. In this lesson, we will learn about the firms/people who link the producers and consumers within a particular country and also about the various options available to consumers to buy the products for their consumption.

OBJECTIVES

After studying this lesson, you will be able to:

- define internal trade;
- explain the meaning and characteristics of wholesale trade and retail trade;
- describe the role of middlemen in internal trade;
- differentiate between wholesale trade and retail trade;
- identify the types of retail trade and their role;
- explain the concept of large-scale retailing;
- explain the merits and limitations of different types of large scale retail trade and
- describe the recent trends in distribution such as direct marketing, tele-marketing and internet marketing.

22.1 MEANING OF INTERNAL TRADE

You know that the goods produced in a country may be sold within the country or outside the country. When buying and selling of goods and services takes place within the geographical boundaries of a country, it is referred to as internal trade. It may take place between buyers and sellers in the same locality, village, town or city; or may be in different states, but definitely within the same country. Internal trade is also called domestic trade or home trade.

To clarify the concept of internal trade let us now learn about its features.

Features of Internal Trade

(a) The buying and selling of goods takes place within the boundaries of the same country.

(b) Payment for goods and services is made in the currency of the home country.

(c) It involves transactions between the producers, consumers and the middlemen.

(d) It consists of a distribution network of middlemen and agencies engaged in exchange of goods and services.

22.2 CLASSIFICATION OF INTERNAL TRADE

Generally we buy goods of our daily use from the local shopkeepers. These shopkeepers buy goods in bulk and sell them to us as per our requirement. But do you know from where these shopkeepers buy those goods? They generally buy goods in large quantity either from the producers directly or from any other shops that sell goods in bulk. Thus, we find that some shopkeepers buy goods in bulk and sell to others in bulk while other buy in bulk and sell in small quantities as per the requirement of the customers. Thus, on the basis of volume of goods traded we can classify internal trade as:

1. Wholesale trade, and

2. Retail trade.

Let us learn more about these two types of Internal Trade.

22.2.1 Wholesale Trade

Wholesale trade refers to buying of goods in large quantity from producers or manufacturer for sale to other traders or buyers in small quantities. Those who are engaged in wholesale trade are called wholesalers. They act as a link between the manufacturers or producers and the small traders. Generally they specialise and deal in one or a few products.

Functions of Wholesalers

1. **Assembling of Goods :** Wholesaler purchases goods from different manufacturers and holds adequate stock.

2. **Grading and Packing :** Wholesalers divide the goods according to their size, weight, shape and quality. In this way he prepares the goods in small lots for sale to retailers.

3. **Transporting :** Wholesalers transport the goods from the production centers to his godown and from there to the retailers. Some wholesalers have their own vehicles for transportation of goods.

4. **Warehousing :** Wholesalers keep the stock for retailers in the warehouse so as to make available goods to the retailers whenever they need them.

5. **Financing :** Wholesalers buy goods from the manufactures and sometime make advance payment. They sell goods to retailers on credit. In this way they finance the manufactures as well as the retailers.

6. **Risk Bearing :** Wholesaler bears the risk of changes in demand during storage. He also bears the risk of damage of goods, risk of bad debt etc.

7. **Providing Market Information :** Wholesaler collect information about changes in the taste, fashion, buying habits etc. of consumers from the retailers, then they pass this information to the manufacturers, so that the manufactures may produce goods according to the requirements of the consumers.

8. **Selling :** Retailers are widely scattered all over the country. Many wholesalers employ sales persons to take orders from retailers. Thus, the wholesalers help in selling goods.

Services Provided by Wholesalers

Wholesalers provide services to the manufacturers and the retailers.

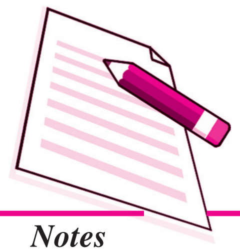
1. **Services to Manifacturers :** Wholesalers render the following services to manufacturers :

   a) ***Bulk Buying :*** Wholesalers collect orders from a large number of retailers and buy goods in large quantities from manufacturers.

   b) ***Warehousing Facility :*** Wholesalers relieve the manufacturers from storing function by holding large stock of goods in their own warehouse. Therefore, manufacturer is relieved of the function of warehousing.

2. **Service to Retailers :**

   a) ***Regular Supply :*** Wholesalers keep a large stock of goods for retailers. They ensure that the goods are available to retailers at all times. In this way they maintain regular supply of goods to the retailers.



Notes

b) ***Financial Help :*** Wholesalers generally sell goods to retailers on credit. The retailers will make payment to wholesalers on the basis of the sales made. So with less capital they can easily manage the business properly.

c) ***Advertisement :*** Wholesalers advertise their good regularly. so, the process of selling goods becomes easy for retailers.

d) ***Market Information :*** Wholesalers provide up-to-date information about new product to the retailers. Wholesalers advice retailers on matters like price, quality and time of purchase.

e) ***Risk Protection :*** Wholesalers keep huge stock of goods and sell to retailers on credit. As a result, retailers have to bear low risk.

22.2.2 Retail Trade

Retail trade refers to buying goods from the manufacturers or wholesalers and selling the same to the ultimate consumers. The retail trader generally deals in a variety of goods. Those who are engaged in retail trade are called retailers. Retailers sell goods in small quantities as per the requirement of consumers.

Characteristics of Retail Trade

Following are the characteristics of retail trade:

(a) Retail trade generally involves dealing in a variety of items.

(b) A retailer makes purchases from producers or wholesalers in bulk for sale to the consumers in small quantities.

(c) Retail trade is normally carried on in or near the main market area.

(d) Generally retail trade involves buying on credit from wholesalers and selling for cash to consumers.

(e) A retailer has indirect relation with the manufacturer (through wholesalers) but a direct link with the consumers.

Services Provided by Retailers

Retailers provide the following services to consumers and wholesalers.

1. **Services to Consumers :** Retailers provide the following services to the consumers.

    a) ***Regular supply of goods :*** Retailers maintain a ready stock of goods for sale to consumers.

    b) ***Convenient Location :*** Retail outlets are situated near residential area and remain open for long hours. The consumers can buy the goods from the retailers at their convenience.

c) ***Wide Choice :*** Retailers stock wide variety of products. Consumers like to purchase everything under one roof. So retailers stock products of different companies providing wide choice to consumers.

d) ***Home Delivery :*** Without any extra charge, some retailers supply goods at the homes of consumers.

e) ***Consumer Education :*** When a new product comes in the market, retailer clearly explain the merits and uses of the product to the ultimate consumers.

2. Services to wholesalers

a) ***Market Information :*** Retailers supply valuable information to wholesalers about changes in tastes, fashion etc. of consumers.

b) ***Help in Distribution :*** Retailers relieve the manufacturers and wholesalers of the burden of collecting and executing a large number of small orders from various consumers.

c) ***Large Scale Production :*** Retailers help manufacturers to operate at a large scale.

d) ***Sell New Products :*** New products will be displayed in retail outlets in a attractive way so as to persuade consumers to buy these products.

INTEXT QUESTIONS 22.1

1. State any two features of 'internal trade'.
2. Identify the following and write 'WT' for wholesale trade and 'RT' for retail trade.
   (a) Dealing in limited variety of product. [ ]
   (b) Goods purchased from wholesalers for resale. [ ]
   (c) Providing facilities like grading and packaging. [ ]
   (d) Buying of goods in bulk from the manufacturers. [ ]
   (e) Trading activities carried on near the residential areas. [ ]

22.3 MIDDLEMEN IN INTERNAL TRADE

Both wholesalers and retailers act as a link between producers and consumers in the chain of distribution of products. They are called middlemen as they come in the middle, i.e., between the producers and the consumers in the chain of distribution.

Producers → **Wholesalers** → **Retailers** → **Consumers**

Chain of Distribution

The middlemen provide useful services to both producers and consumers. For the producer, they free him of the complexities of arranging for transport, warehousing, financing and marketing of his produce to a large extent. The responsibility of the producer gets limited to producing the product. Largely all efforts to sell and distribute the same is taken up by these middlemen. For the consumers too, these middlemen are beneficial as they make the products available at the place and time of convenience to them.

Now let us, learn in detail the role of wholesalers and retailers in the chain of distribution.

22.3.1 Role of Middlemen in the Distribution of Goods

(a) **Role of Wholesalers :** The wholesalers through their services offer a number of benefits to the producers and retailers. They save the time and effort of the producers and allow them to concentrate on production of the goods while distribution is taken care of by the wholesalers. They deal with goods in bulk and reap the benefit of economies of scale. They provide goods in relatively small quantities to retailers and provide them with facility of credit purchase. They provide information to the producers about the consumers' preferences, changing taste and fashion, market demand etc. Wholesalers also bear the risk involved in holding of stock of goods and its transportation.

(b) **Role of Retailers :** Retailers are engaged in selling the product to the end-users or the consumers. They cater to the demand of the customers by providing a variety of products collected from different locations. The retailers may offer credit facility to customers. They also offer pre and after sales services and communicate to consumers the technique of usage of the products. They act as salesmen of the product and persuade buyers to purchase goods and services. They provide information to the manufacturers or wholesalers about the feedback on consumers' response to the product.

22.3.2 Evaluation of the Role of Middlemen in the Chain of Distribution

As seen above, the middlemen provide a number of services in the process of distribution. Do they charge any money for their services? Yes, these services of middlemen do not come free of cost. They do charge their share of profit margin for the product, in return for the services they provide. This increases the sale price of the product considerably, as compared to the cost incurred in producing it. For example, a pen that costs Rs. 5/- to produce, may be sold by the producers to the wholesalers for Rs 6/-. In turn the wholesaler may sell it to the retailer for Rs. 7, who in turn may sell it to the ultimate consumer for Rs. 8.50. The middlemen's share of profit here is Rs. 2.50 (Re. 1 + Rs. 1.50) that has added considerably to the price of the product.

Producers (₹ 5) → **Wholesalers (₹ 6)** → **Retailers (₹ 7)** → **Consumers (₹ 8.50)**

(Price of the product in the Chain of Distribution)

It is often debated that the middlemen do not serve any useful purpose, but only escalate the price of a product unnecessarily. However, we must not forget that they render useful services to producers and consumers. To that extent, they are justified to get their share of profit in the sale of the product. But it should be a reasonable and not too high to become a burden on the consumers.

We must also give a thought to some of the problems that stem from the presence of middlemen in the chain of distribution.

If there are too many middlemen between manufacturers and consumers, each charging his share of profit or commission, the ultimate consumer ends up paying a very high price for the goods. Some middlemen indulge in unfair trade practices like hoarding and adulteration to increase their gains from the business. They, at times, promote the sale of inferior quality goods and exploit the consumers to get a high profit margin for themselves. The middlemen do not bear risk such as loss due to strikes, lockouts, changes in fashion and consumption habits. These have to be primarily borne by the producer. Sometimes the transfer of goods from one middleman to another causes delay in the smooth flow of goods, instead of facilitating it.

Nonetheless, when we compare the benefits of middlemen with the problems they pose, their benefits definitely outweigh the problems. In conclusion, one can clearly say that the middlemen play the role of a vital link between producers and consumers in the chain of distribution.

Now, let us compare the wholesale trade with retail trade.

22.3.3 Difference between Wholesale Trade and Retail Trade

Following are the differences between wholesale trade and retail trade:

Basis	*Wholesale trade*	*Retail trade*
1. Number of items	Deals in a few items.	Deals in a variety of items.
2. Quantity of goods bought and sold	Large	Small
3. Source of purchase	Manufacturers	Wholesalers/producers
4. Main activity	Sells goods for resale. resale.	Sells goods for consumption or final use.

5. Amount of capital required	Large	Small
6. Nature of relationship with producers/ consumers.	Direct link with the producers and indirect link with the consumers.	Indirect link with the producers and direct link with the consumers.
7. Location	Located in the same area along with other wholesalers dealing in similar product.	Located near residential areas.
8. Display	Does not require elaborate display of goods.	Requires display of products attractively.

INTEXT QUESTIONS 22.2

1. The middlemen should be eliminated. Do you agree? Give one reason.
2. Rectify the following sentences if found wrong.
   (a) A wholesaler has direct link with the consumers.
   (b) The amount of capital required is less in case of wholesale trade.
   (c) Producer is a middleman in the chain of distribution.
   (d) Presence of too many middlemen increases the price of the product.
   (e) The wholesaler purchases goods from the retailer.

22.4 TYPES OF RETAIL TRADE

You have learnt about Retail trade in the previous section. In your village or town, you buy products from the nearby shops in small quantities. In cities you can buy a product from a large shop or a variety of products from a large number of counters in one big shop. They are all engaged in retailing business.

We can classify the retailing business on the basis of size as small scale, medium scale and large scales. On the basis of forms of ownership, it may be sole proprietorship, partnership, cooperative society or joint stock company. But the most common way of classifying retailing business is whether they have any fixed place of business or not. On this basis, one can have two categories of retailing business :

1. Itinerant Retailing
2. Fixed shop Retailing

22.4.1 Itinerant Retailing

Itinerant retailing is a type of small-scale retail trade in which retailers move around and sell a variety of items directly to the consumers. They do not have a fixed shop where they can sell. You must have seen them distributing newspapers early in the morning; selling peanuts, bangles, toys etc. in buses and trains; selling fruits and vegetables in your locality using a cart, selling ice-cream, *namkeens* etc. on a cycle; selling rice, earthen pots or even carpets by using a cart, etc. You can also see them on pavements in your locality.

In towns and cities we come across different type of itinerant retailers. There are traders who sell their articles on fixed days at different market places. In villages these market places are called "*Haat*" and in towns or cities they are called "weekly bazars". The itinerant retailing also includes persons selling products from door to door. In most cases, the price of items is not fixed and mostly settled through bargaining. Moreover, in most cases the items sold are not branded products.

22.4.2. Fixed Shop Retailing

Here, the retailers sell goods and services from a fixed place known as 'shop'. They do not have to move from place to place to serve their customers. These shops are usually located at market places or commercial areas or near residential localities. These shops normally deal with a limited variety of goods. On the basis of the volume of transaction or size of their operation, fixed shop retailing can be classified as

(a) small scale fixed shop retailing, and

(b) large scale fixed shop retailing.

Let us know about these two categories.

(a) Fixed Shop Retailing – Small Scale

In every locality you find fixed shop retailers dealing with goods and services on a small scale. They deal with limited variety and limited quantity of goods and cater to the needs of a local area. They require less capital and provide goods to a limited number of customers. The grocery shops of your locality come under the category of small-scale fixed shop retailing. On the basis of the nature of goods they deal in, we can classify these retailing businesses as :

(i) General store or Variety store

(ii) Single line store

(iii) Specialty store

(iv) Second-hand Goods shop

Let us know the details about these stores.

(i) ***General Store or Variety Store :*** These stores, as the name suggests, deal with a variety of items of general use. They sell products mostly required by people for their daily use. For example, in a variety store you can find different items of toiletry, hosiery, biscuits and snacks items, grocery, cosmetics, gift items and stationery, etc. Normally these retailers make direct sale by cash only. However, for their regular customers, these retailers may give discount, provide credit facility and also free home delivery of goods.

(ii) ***Single Line Store :*** These stores deal with a specific line of goods. You must have seen medicine shops, bookshops, toy shops, ready-made garment shops, etc. These are all single line stores. They sell goods of different size, brands, designs, styles and quality of the same product line.

(iii) ***Specialty Store :*** These stores deal with products of a specific brand or company. All varieties of any particular brand or manufacturer are made available in these stores. You must have seen stores, like Woodland shoe shops where products starting from shoes to apparel produced by Woodland company are made available to the customers.

(iv) ***Second-hand Goods Shop :*** Now-a-days in cities and towns we find shops selling second-hand goods or used goods. These shops generally sell goods like books, furniture, clothes and other household items.

INTEXT QUESTIONS 22.3

1. What is meant by 'Itinerant Retailing'?
2. Identify the types of retailing business.
   (a) Stores dealing with a particular line of good like books, toys etc.
   (b) Stores dealing with a variety of goods of a particular brand.
   (c) Stores dealing with a variety of goods of daily use.
   (d) Selling goods on the pavement of a city.
   (e) Stores selling used books or garments at cheaper price.

(b) Fixed Shop Retailing – Large Scale

Apart from small-sized outlets, as discussed above, there are a number of large-sized retail shops that sell products on a large-scale. They come under large-scale fixed shop retail trading category.

Notes

Large-scale retail trade is the type in which single type of goods or a variety of goods is made available to a large number of consumers either in a big shop under a single roof or in various shops at the convenience of customers or directly delivered at the place of the customers.

Types of Large-scale Retail Trade

In India, generally we find the following types of Large-scale retailing business:

(i)	Departmental Store	(ii)	Multiple Shops
(iii)	Super Market	(iv)	Consumer Cooperative Store
(v)	Mail Order Retailing	(vi)	Franchise

Let us now discuss in details about all these types.

(i) Departmental Stores

Departmental Store is a large-scale retail shop where a large variety of goods are sold in a single building. The entire building is divided into a number of departments or sections. In each department specific type of goods like stationery items, books, electronic goods, garments, jewellery etc. are made available. All these departments are centrally controlled under one management. Once you enter such a store you can do all your shopping by moving from one department to another. To encourage people to do all their shopping in one store, these stores also provide facilities like restaurant, telephone, toilet, ATM etc., for the conveniences of customers. These stores also provide the facility like free home delivery of goods, execution of telephonic order for goods, credit facility, etc. It is generally located at the main commercial centres of the cities and towns, so that customers from different localities can easily come to buy goods as per their convenience. Big Bazar, Vishal Megamart, Ebony, Shoppers' stop are some of the leading departmental stores in our country.

Merits of Departmental Stores

(a) They sell a large variety of goods to consumers, under one roof. So it saves time and effort of the customers.

(b) Departmental stores offer wide variety of goods produced by different manufacturers.

(c) They buy large volumes of goods, at a time directly from manufacturers, and get good amount of discount from them. They are able to reap the benefits of economies of large-scale operations.

(d) Since these stores are organised on a large-scale basis, they can afford to employ efficient and competent staff to provide the best services.

(e) Each department that is a part of the departmental store in a way advertises for the other departments. While visiting one department customers are attracted to see and even buy the goods displayed in other departments.

Inspite of these advantages departmental stores have certain limitations also.

Limitations of Departmental Stores

(a) Large amount of capital investment is required to start and run a departmental store.

(b) They are generally located at places far from residential areas, so they are not very convenient for buying goods of daily use.

(c) The operating cost of the departmental stores is very high since it includes cost of location (in the form of rent or purchase price of building), decoration of building, salary of large number of employees and provision of various facilities for the convenience of customers.

(d) There is no direct contact between owners and customers in departmental stores. It is the employees of the store who interact with customers. The owners do not get first-hand information about the tastes, preferences, likes and dislikes of the customers.

(ii) Multiple Shops

In the previous section, we learnt that in a departmental store, the whole business is carried on in one building and the customers are drawn to it. Now we shall learn about multiple shops under which big manufacturers approach customers by setting up shops near the customers.

Have you ever observed that there are some retail stores running in your town/city having the same name, same decoration and dealing in the same type of products under a single brand name. Yes, you may say, there is Raymonds, Nirula's, McDonalds, etc. These are multiple shops. They sell similar range of commodities at the same price in all their shops. These shops are usually owned and run by big manufacturers/producers. They open a number of branches at different localities in a city or in different cities and towns in a country. These shops are also called 'Chain Stores'. Multiple shops deal with similar types of goods mostly of everyday use e.g., shoes, textiles, watches, automobile products, etc. The price is uniform for similar items in all the shops. These shops are usually conveniently located in the main market place or in busy shopping centers.

Merits of Multiple Shops

The multiple shops offer the following advantages to buyer and sellers. Let us learn about them.

(a) All multiple shops are often built alike, that helps customers to recognise the shops easily. They have similar window display, interior decoration of the shop and arrangement of the counter, furniture, sign boards etc.

(b) They facilitate elimination of middlemen (wholesalers and retailers) in the process of distribution.

(c) These shops enjoy the benefits of large-scale purchase or production of goods (centralised purchase/production). Also, due to common advertisements these shops are able to save on the cost of advertising.

(d) The customers can get the goods at a cheaper rate because of low operating cost and elimination of middlemen in the process of distribution.

(e) Since the customers get genuine and standardised goods directly from the manufacturers, chances of duplication of goods and cheating does not arise in these shops. Also, standard quality and uniform price of products help in winning the confidence of customers.

Limitations of Multiple Shops

Inspite of all the above merits, multiple shops also suffer from the following limitations.

(a) These shops deal in a limited variety of products and restrict the choice offered to customers.

(b) Sales are made on cash basis only and the customer cannot avail of credit facilities from these shops.

(c) Customers cannot bargain with sales person while buying the product. The prices of the product are fixed by the head office and individual shops have no control over it.

(d) Each of the multiple shops is generally managed by the branch managers and they strictly follow the instructions of the head office. Often, they do not take initiative or special interest in satisfying the customers.

INTEXT QUESTIONS 22.4

1. The decoration, display, sign boards etc. of the multiple shops are built alike. Why? Give reason.

2. Answer the following.

   (a) Who owns the departmental stores?

   (b) Who owns the multiple shops.

   (c) Which stores deal with variety of goods under one roof?

   (d) Who manages the day to day affairs of the multiple shops?

(iii) Super Markets

Super Market is another kind of large-scale retail organisation from where we can buy most of our household requirements for a week or a month in one visit. Let us learn about this form of large scale retailing system in detail.

Super Market is a large scale retail store that sells a wide variety of products like food items, vegetables, fruits, groceries, utensils, clothes, electronic appliances, household goods etc. all under one roof. It is formed with the objective of selling goods of daily necessity to general public at a reasonable price by eliminating the middlemen in the process of distribution. These stores are centrally located and also establish their branches near the residential areas. As compared to departmental stores, super markets donot offer free home delivery facility, credit facilities etc. You will also not find salespersons to convince the customers to buy the goods. Here, customers pick up the items of their requirement and bring it to the cash counter, make payment and take the delivery.

Merits of Super Markets

Let us consider the merits of super markets.

(a) Super markets deal with a wide range of goods of daily household needs.

(b) It provides standard quality items to the customers. Chances of adulteration and duplication are minimal/almost nil.

(c) Due to economies of large-scale purchase and avoidance of middlemen the goods are available at a cheaper price in super market.

(d) In a super market normally services of salesmen and shop assistants are not available. This reduces the cost of operation.

(e) A customer can find goods of different brands at one place. This makes comparison and selection easy. You can take your own time to select items of your choice.

Limitations of Super Markets

Following are some of the limitations of super markets :

(a) Super markets require large amount of capital to start and run them.

(b) Because of insufficient funds, benefits of professional management are not available to the super bazar.

(c) Goods are sold to the customers only on cash basis. Credit facility is not available to them.

(d) Super markets follow the principle of self service. So the items which require the service of salespersons are normally not dealt by super market.

(iv) Consumer Cooperative Stores

Consumer Cooperative Store is another form of large scale retail trade which is owned by the cooperative society. When the consumers of a particular area or group find it difficult to get the items of daily necessity they usually form a cooperative society and run the retailing business. The consumer cooperative store purchase the goods directly from manufacturers or dealers and make them available at a cheaper price. Let us see the various merits of consumer cooperative stores.

Merits of Consumer Cooperative Stores

(a) The consumer cooperative stores generally provide the goods at a lower price than the market, because they eliminate the profits of middlemen in the process of distribution.

(b) These stores sell the goods on cash basis. So the risk of bad debts is avoided.

(c) These stores are generally located near the residential area for the convenience of the members as well as general public.

(d) The profit earned by the consumer cooperative stores are distributed among the members as bonus.

Limitations of Consumer Cooperative Stores

(a) The consumer cooperative stores generally suffer from the limitations of inadequate funds because these stores are formed by the people belonging to limited income group.

(b) Lack of fund or resources restrict the growth and expansion of business.

(c) These stores are managed by the member who may not have sufficient experience in business management. Again, due to limited funds it is also not possible to engage professional managers.

INTEXT QUESTIONS 22.5

1. List five items of daily necessity that are available in super markets.

2. Make necessary corrections and rewrite the following sentences:

   (a) Consumer cooperative stores are generally located at far off places from the residential area.

   (b) The presence of sales person is very much required in super markets.

   (c) The profit earned by the consumer cooperative stores is distributed among the members.

   (d) Professional managers are engaged in the consumer cooperative stores to manage the day to day affairs.

(v) Mail Order Retailing

As the name suggests, this form of retailing makes use of the mail system (postal and courier) to communicate with and deliver the goods to the customers. You must be wondering how the customer comes to know about this retailer and the products he/she is selling without visiting the shop? To answer this question, let's now discuss the details of how the mail order retailing system operates.

The mail order retailers place the advertisements in newspapers, magazines etc. or publicise about their products in booklets, catalogues, brochures and handouts. These advertisements, leaflets, brochures etc. contain an order form or other details on how to order the product apart from a detailed description of the product being sold. On seeing the advertisement the interested customers can place an order by post and the retailer on receiving the order, dispatches the goods by post or courier. The payment for the same is either made by the customer through the money order or demand draft (at the time of ordering the goods) or through cash-on-delivery/VPP (Value Payable Post) arrangement (i.e., payment is made by the customer on receiving delivery of goods, not in advance).

This method of sale can be conveniently used by the buyer to order goods of his choice while sitting at home and the seller can sell his products even to customers living in very remote areas. However, this system is not suitable for all types of goods. Goods that do not need personal inspection and whose use can be understood by description only (books, plants seeds, cutlery) and light weight, non-perishable products (certain medicines, cosmetics, readymade garments, relatively low- valued electronic gadgets, cameras etc.) that occupy less space are suitable for mail order retailing. Goods having high demand in the market and those having delivery charges relatively lower than their price are also suitable.

Merits of Mail Order Retailing

The mail order retailing system has the following merits :

(a) It is economical to start and run such a business because no shop has to be set-up for it. This saves the cost of rent for the shop, its decoration, employment of salespersons etc.

(b) There is not only low capital investment but also efficient use of that capital in mail order retailing. There is no wastage of money in transporting the goods from one middleman to another. Goods are directly dispatched to the customers. Moreover there is no requirement of maintaining a stock of the finished product or display of goods in shelf for sale. Goods may be manufactured or procured after receiving an order from the customer. This reduces the need to block the capital in maintaining stock of goods to minimum.

(c) Mail order retailers have a wide geographical reach. They can cater to customers scattered over a wide area (in different countries also). The only requirement is that there should be postal or courier services available in that area.

(d) Customers can order goods from the convenience of their home and receive the goods at their doorstep under this system. People living in remote areas also get access to a wide variety of goods.

(e) Customers also derive benefit from the comparatively low price that the mail order retailers offer due to their low operating cost.

Limitations of Mail Order Retailing

Mail order retailing has certain limitation which are given as under:

(a) Since there is no opportunity for the customer to personally examine the goods that he/she is buying, there is a probability that the customer may not get the desired product. The product may vary in size, color, design etc. from the one that shows in the advertisement or catalogue.

(b) There is no personal, face-to-face contact between the customer and the retailer. As a result, the customer is unable to clear all his doubts regarding the product, its use and its maintenance.

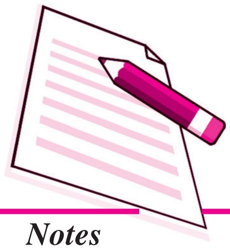
(c) Products that are ordered through this mode take some time to reach the customer. The customers have to wait till the order reaches the retailer, then the procurement and dispatch of goods by him and finally the goods reach the customer. Hence, this is not suitable for perishable products or products required immediately or on a short notice.

(d) Mail order retailing is not suitable for all products. Items of daily consumption, bulky or voluminous articles and perishable goods cannot be bought and sold through it.

(e) Mail order retailing is conducted mainly on cash basis. Credit facility is not provided to the customer.

After going through the merits and limitations of mail order retailing, a question may arise in our minds – Is mail order retailing a popular form of trade in our country? Even though this system exists since a long time, its use is not widespread. Have you wondered why is it not so popular, especially in our country?

Apart from its limitations that have been discussed above, there are certain other reasons why this business has not been very popular in India. A large section of our population is still illiterate due to which they are neither able to read the advertisements/catalogues of mail order retailing nor place an order for such goods. Due to some instances of



Notes

fraud and other malpractices by certain retailers, customers do not have much confidence in mail order retailers. Possibility of fraud is more in this case than in face-to-face purchase of products from shops. Also, lack of credit facility dissuades a large section of our population from purchasing goods through the mail order system.

(vi) Franchise

You might have seen some restaurants, card and gift shops, readymade garments shops that carry the same brand name/trademark and have almost the same decoration. They sell the same products, yet they are not chain stores/multiple shops. This is because they are not controlled and managed by a single owner. You may be wondering how these different shops are able to use the same brand name, sell the same product etc. even though they are not under the same management. Moreover, these shops are run independently by different people in different localities. This is made possible through a retail arrangement called 'Franchise'.

Franchise is a form of retailing wherein two parties enter into an agreement in which one party authorises others to sell or produce and sell specified goods and services. The party that develops a product/service or is the owner of an expertise is called the 'Franchiser'. The other party, called the 'Franchisee' is an independent business unit that buys the right to sell the product/service of the franchiser in exchange of the specified amount of money. The franchisee functions as a retailer. He operates in certain geographical areas that he is permitted to, as per his agreement with the franchiser.

Franchising has gained popularity in our country, especially in the past decade. There are many businesses like fast-food joints and restaurants (e.g., McDonalds, Wimpy's), gifts and greeting cards shops (Hallmark, Archies), readymade garments (Benetton, Numero Uno, Petals), computer education (NIIT, Aptech) that have grown nation-wide and are flourishing with the help of franchise arrangements.

Features of Franchise

Let us now know more about franchise by looking at its features:

(a) It is based on an agreement between the franchiser and the franchisee, wherein they enter into a commercial relationship, generally for a specific period of time.

(b) Under this agreement, the franchisee gets the right to use a particular brand name, process or product owned by the franchiser, for the purpose of retailing, in return of a fee.

(c) The fee is generally paid partly as an initial payment at the time of entering into the contract and partly on regular payments either in monthly, quarterly or annually. This regular payment may be paid by the franchisee as a percentage of his sales volume or profit or a fixed amount agreed upon in the contract.

(d) The franchiser may also be required to invest money in arranging a large space in prime locations, in furnishing it and in procuring stock for the outlet. In most cases all franchise outlets are required to maintain uniform pre-determined decoration, method of serving customers, type of products etc.

(e) Franchise as a system of retailing is suitable for brands that have earned a name for themselves in the market. Only then can a franchisee benefit from using that name over a new brand.

(f) The franchiser is very cautious while choosing franchisees for his goods or services. Only competent persons with requisite entrepreneurial skills and commitment to quality/customer-satisfaction, in addition to, of course, a sound financial position will be able to run this business successfully. A franchisee who fails will bring disrepute to the brand and also hamper the franchiser's future business prospects.

Merits of Franchise

(a) The Franchiser can expand his business without investing additional capital. The franchisee invests this money and also pays fee to franchiser in return of the right to use the brand name, products etc.

(b) The Franchisee can capitalise on the goodwill of the existing brand of the franchiser.

(c) The customer gets assurance of standardised goods and services both in terms of quality and price. With the network of franchisees, the product and service becomes widely available to consumers.

Limitations of Franchise

(a) The Franchiser does not have close control over the activities of the franchisee. The franchisee's poor performance in dealing with customers may bring a bad name to the brand due to which the franchiser's business may be adversely affected.

(b) If the franchisee is not able to make adequate profit out of the franchise business, the franchise fee may become a burden for him.

(c) If consumers have complaints regarding the product/service, he may face a problem about whom to go to, the franchiser or the franchisee. Each may blame the other for the problem and not take on the responsibility of redressal of the grievance.

INTEXT QUESTIONS 22.6

1. Name any five products that are suitable for mail order retailing.

2. Define the following terms.

   (a) Franchise (b) Franchiser (c) Franchisee

Notes

22.5 RECENT TRENDS IN DISTRIBUTION

With the advancement in the information technology (i.e., use of computers, telephone, internet etc.) methods of distribution of goods from producers to consumers have witnessed new developments. Today consumers can conveniently buy products of their choice without leaving their home or office, any time during the day or night. Certain channels of distribution eleminate the long and expensive chain of middlemen. Manufacturers are directly approaching consumers, either through their websites using Internet or through their agent (direct selling).

Some of the recent trends in distribution are discussed below.

(a) Direct Marketing : Under this method of distribution the manufacturers bypass the chain of middlemen and approach the consumers directly and sell them the goods and services, without the help of wholesalers and retailers. The manufacturers inform the prospective customers about their products and its uses through advertisements (in newspapers, television, radio) or catalogues, letters and brochures. If the customer wants to buy the product, he/she may place an order to the manufacturers over the telephone or through a letter sent by post or e-mail. The product gets delivered to the customer through courier, post or by salespersons.

The benefit of direct marketing to the producer as well as consumer is in the form of doing away with the profit margin of middlemen. The manufacturer is able to supply goods to the consumer at a lower price, even after keeping a larger share of profit margin as compared to the situation of distribution through middlemen. Also, the time consuming process of the product changing hands from the producer to the wholesaler, then to the retailer and finally to the consumers, is avoided. Transactions are faster when the producer is face-to-face with the consumer. Also, the producer gets direct feedback from the customers for improvement in the products.

Direct marketing may be classified into different types, based on the mode of communication used by the manufacturers to approach the customers. The manufacturers may use

- Printed catalogues to inform the customers about the products called Catalogue Retailing;
- Television advertisements called Televised Shopping; and
- Brochures, letters etc. sent by mail called Direct Mail Retailing.

Products that can be conveniently and safely sent to the customers by post/courier and whose utility and description can be easily communicated through a catalogue, letter or television advertisement, are generally sold using the method of direct marketing. This includes books, magazines, physical exercise equipments, certain types of furniture etc.

(b) Internet Marketing : With the widespread use of computers and Internet, today it is possible to buy and sell products over the internet, through websites maintained by producers. Products can be ordered instantly from anywhere in the world, 24-hours of the day, from the convenience of one's home or a nearby cyber-cafe.

On the website we can see the picture of the product, read about it and then order it, just with the click on the mouse of the computer. The payment for the product may be made using a credit card or by bank draft etc.

Internet marketing makes it convenient to do shopping anytime, anywhere and it is easy to compare prices of the same product charged by different producers. The only thing we have to do is to open different websites on the Internet. There is no need to physically go from one shop to the other, or one market to the other.

We can buy all types of products from flowers to foods, clothes to computers, from producer located even at a far-off place in some other country or continent. The producer is able to cater to a larger number of customers sitting anywhere in the world, efficiently and speedily, using Internet marketing.

But a drawback of this means of distribution is that the consumer can only see the image of the product. He/she cannot see the actual product nor touch it, try it nor witness a live demonstration of its use. Full information about the product may not be available on the website.

(c) Telemarketing : Some producers/manufacturers approach the consumers over the telephone, to tell them about the product and its uses and ultimately persuade them to buy the product. This method is often used to sell credit cards, subscription to certain books and journals and also membership of certain clubs etc.

A marketing representative of the concerned producer calls up prospective customers over the telephone and tells them about the product and its uses. While interacting the caller can gauge the interest level of the customer towards the product and influence his decision to buy the product. If the customer is willing to buy the product, it is delivered to him by courier or post.

Now a days, if a large number of customer are to be approached through telemarketing, computerised calling system is used instead of a person calling up customers. The desired telephone numbers are dialed mechanically and the computer plays a pre-recorded voice message for the consumer. The consumer is given the option, after hearing the message, to record his own message that may be a query about the product or the order to purchase the product.

22.5.1 Retailing in the Changing Times

You have read in the previous sections about the different forms of retailing, from hawkers and peddlers to huge departmental stores; from local general stores to mail order retailing Internet Marketing and Telemarketing.

As business has evolved over the ages, retailing, an important and dynamic part of it, has also kept pace with the changes. However, in the recent past there have been such drastic and far-reaching developments in this field that it is said that we are presently experiencing a 'retailing revolution', not only in India, but the world over.

Retailing has come a long way today in our country, from the local Kirana shops that existed since long, long ago. The focus now is not only on making retailing more convenient for the customer but also on making shopping an enjoyable experience for him/her.

The shift in approach in retailing aims at earning profit by offering customers more choice, more convenience and better facilities.

Let us now read about some of the interesting trends that have emerged in retailing, that you may have also observed on your own.

- In keeping with the changing lifestyles of consumers where they now have more purchasing power but lesser time, retailers are offering services like free home delivery, pre-packed goods (milk, juice etc.), after sales services, convenience of shopping for different products under one roof (departmental stores) and shopping through the Internet, e-mail, post, SMS or telephone.
- Many businessmen who were earlier focusing only on manufacturing of products, are now venturing into retailing (vertical integration). They are either opening their own exclusive showrooms/outlets under their brand name or tying up with existing retailers or employing direct selling agents (that link the manufacturer to the consumer by directly selling goods to final consumers, eliminating wholesalers and other retailers from the chain).
- In order to encourage consumers to buy products, retailers are offering attractive schemes of financing products, especially for consumer durables like refrigerators, television, air-conditioners etc. Very low rates of interest are charged by the retailer for financing the product. Some retailers also have tie-ups with banks for the purpose of providing consumer finance.
- With a view to offer variety to consumers with convenience and easy accessibility, today retailing includes automatic vending machines. Through these machines, consumers can buy items like newspapers, magazines, chocolates, contraceptives, cold drink cans and so on by inserting requisite denomination of coins and pressing a button. The item gets delivered from the machine without any human intervention.

- Shopping malls have been another outcome of the 'retail revolution' in urban areas. They are like a huge shopping complex, housed in a single building, generally offering services like parking space, recreational facilities like cinema halls, variety of food outlets/restaurants (food courts) apart from a number of shops selling different goods. They may include a departmental store spread over multiple storeys/ floors, apart from a number of other independent shops, all under the same roof. Shopping malls have gained popularity with consumers because they offer a convenient shopping experience to them, due to the many other facilities that they house. They are generally designed in such a way that they are accessible to the differently abled persons with facilities like ramps, wheel chairs etc.

- Another development in recent times has been the use of multiple channels for retailing a single product i.e., selling the product through mail order as well as through departmental stores or through itinerant retailers, general stores as well as over the Internet at the same time (for e.g., Amul Ice cream is sold through pushcarts, in local grocery shops, in departmental stores, and over the Amul.com website).

  Some retail outlets are also using multiple format retailing, where the retail outlet combines the features of two different types of retailers. For e.g., a departmental store and chain store combination in the form of a chain of departmental stores across different parts of the country like Big Bazar, Vishal Megamart.

- The combination of a super market and a departmental store forms a hypermarket. It is a large scale retail facility which provides enormous range of products under one roof. A consumer can buy all his/her weekly or monthly requirements in one trip from the hypermarket.

Thus, we can see that trade within the country (internal trade) may assume different forms, depending on the needs and demands of consumers. Newer features in existing forms or newer forms of retailing keep developing with changing times and changing consumer preference.

22.5.2 Chamber of Commerce and Industry

Chamber of commerce is a voluntary association of business people. Manufacturers, merchants and other business persons in a particular region or country will be the members of Chamber of Commerce and Industry. This organisation is formed to promote general business interests of all the members. Chamber of commerce promote the growth of commerce and industry in a particular region or country. This is a non-profit making organisation.

22.5.3 Documents Used in Internal Trade

Following documents are used in internal trade :

1. **Performa Invoice :** It is a document sent prior to the actual sale to the buyer. It informs the buyer about the amount he is required to pay for the specified goods purchased by him. It provides almost the same information as an invoice provides. It is sent in the following cases :

    a) When goods are sent on consignment basis.

    b) When goods are sent abroad.

    c) When supplier expects payment before dispatch of goods.

2. **Invoice :** It is a document sent by the seller to the buyer when goods are supplied. It is a document which shows the nature rates and terms of payment at which goods will be dispatched. Invoice perform the following functions :

    a) It help the buyer to locate error in the order and supply of goods.

    b) It is a basis for recording transactions.

    c) It informs the buyer about the dispatch of goods.

    d) Seller can have an idea of the amount to be collected from buyer.

3. **Debit Note :** It is a document prepared by one party (either by the seller or the buyer) to inform the other party (either the seller or the buyer) that receiver's account has been debited with the specified amount and for the specified reasons.

    Seller may send a debit note to the buyer in the following cases :

    a) When the goods are undercharged in the invoice.

    b) When some goods are not included in the invoice by mistake.

    c) When some more items have been sent than invoiced.

    Buyer may send a debit note to the seller in the following cases :

    a) When the goods are returned by the purchaser to the seller and seller is ready to give allowance to the buyer for the same.

    b) When the seller failed to sent same goods charged in the invoice.

    c) When the price charged in the invoice is higher.

4. **Credit Note :** It is a document prepared by one party (buyer or seller) to be sent to another party (buyer or seller) to inform the receiver that his account has been credited with the amount mentioned and for the reasons stated therein.

    A seller may send a credit note to the buyer in the following cases :

    a) When goods are returned by the purchaser.

b) When same goods are damaged and acceptance has been made by the buyer at a reduced price.

c) When less goods have been sent than invoiced.

A buyer may send a credit note to the seller in the following cases :

a) When the seller has by mistake sent more goods than invoiced.

b) When same item has not been charged in the invoice by mistake.

22.5.4 Lorry Receipt (LR)

When the goods are sent through a transport company, a Lorry Receipt is issued by Transport Company at the time of booking.

1. Name, address and phone number of the transporter.
2. Name, address and phone number of the sender.
3. Name, address and phone number of the person to whom the goods are likely to be delivered.

22.5.5 Terms of Trade

i. Cash on Delivery (COD) : It is a type of transaction in which payment for goods is made at teh time of delivery. If the purchaser does not make payment when the goods are delivered, then the goodwill be returned to the seller.

ii. Free on Board (FOB) : This include all charges at the post of shipment upto the loading of goods on board the ship and export duty, if any.

iii. Los, Insurance and Freight (CIF) : This includes the cost of goods all expenses incurred for taking the goods to the post of destinations and insurance charges.

iv. Errors and Ommisions Excepted (E & OE) : It is expression that is used as a disclaimer against clerical errors.

INTEXT QUESTIONS 22.7

1. What is meant by 'Shopping Mall'?
2. Name the method of distribution in the following cases :

   (a) The manufacturer approaches the customers directly.

   (b) The marketing representative calls the customs over telephone.

   (c) Sale of goods and service by using internet.

   (d) Sale of goods through machines without any human intervention.

WHAT YOU HAVE LEARNT

- Buying and selling of goods and services within the geographical boundaries of a country is referred to as internal trade.
- On the basis of volume of goods traded we can classify internal trade as wholesale trade and retail trade. Wholesale trade refers to buying of goods in large quantity from the producers or manufactures for sale to other traders or buyers in small quantities. Retail trade refers to buying goods from the manufacturers or wholesalers and selling them to the ultimate consumers.
- **Types of Retail trade**

  - ***Itinerant Retailing***
    - Peddlers and hawkers
    - Market traders
    - Street traders
  - ***Fixed shop Retaining***
    - **Small Scale**
      - General store
      - Single line store
      - Speciality store
      - Second-hand goods shop
    - **Large Scale**
      - Departmental stores
      - Multiple shops
      - Super Markets
      - Consumer Cooperative Store
      - Mail Order Retailing
      - Franchise

- The advancement in the Information Technology has brought a revolution in the retailing business in India and the world over. Today producers and manufacturers are approaching the customers through different innovative methods like direct marketing, internet marketing, telemarketing etc. Retailing is now aiming towards earning profit by offering customers more choice, more convenience and better facilities.

KEY TERMS

Consumer cooperative store	Departmental store	Direct marketing
Fixed shop retailing	Franchise	General store

Internet marketing	Itinerant retailing	Mail order retailing
Multiple shops	Retail trade	Second-hand goods shop
Shopping mall	Single line store	Specialty store
Super Market	Telemarketing	Wholesale trade

TERMINAL EXERCISE

Very Short Answer Type Questions

1. What is meant by 'Internal Trade'?
2. State the meaning of multiple shops.
3. Mention any two benefits of wholesaler.
4. Define the term 'Franchise'.
5. Name any four types of large scale retailing business.

Short Answer Type Questions

6. Explain the role of wholesaler in the distribution channel.
7. State any four merits of departmental stores.
8. Give any four points of distinction between a retailer and a wholesaler.
9. Explain the merits of super markets.
10. What is meant by 'mail order retailing'?

Long Answer Type Questions

11. State the features of Departmental stores. How is a departmental store different from multiple shops?
12. Describe the role of middlemen in the channel of distribution.
13. What is meant by Consumer Cooperative Store? Explain its merits in brief.
14. Explain the features of Franchise as a form of large scale retailing business.
15. Describe in brief, the recent trends in distribution.

ANSWERS TO INTEXT QUESTIONS

22.1 2. WT : (a), (c), (d) RT : (b), (e)

22.2 2. (a) A retailer has direct link with the consumers.
(b) The amount of capital is less in case of retail trade.
(c) Wholesaler/Retailer is a middleman in the chain of distribution.
(d) No change
(e) The retailer purchases goods from the wholesaler.

22.3 2. (a) Single line store (b) Specialty store
(c) General store or variety store (d) Itinerant retailing
(e) Secondhand goods shop

22.4 1. (a) Same ownership (b) Easy to recognise

2. (a) Big businessman (Individual or group)
(b) Big manufacturers or producers
(c) Departmental store
(d) Branch manager or any body appointed by the owner.

22.5 1. (a) Food items (b) Vegetables (c) Fruits
(d) Groceries (e) Utensils

2. (a) Consumer Cooperative Stores are generally located near the residential areas.
(b) The presence of salesperson is not required in super markets.
(c) No change
(d) The Consumer Cooperative Stores are managed by the members who may not have professional expertise in business management.

22.6 1. (a) Medicine (b) Books (c) Toys
(d) Cosmetics (e) Plant seeds

2. (a) Franchise is a form of retailing where two parties enter into an agreement in which one party authorises the other to sell or produce and sell specified goods and services.
(b) The party that develops a product/service or is the owner of an expertise who authorises other to sell or produce and sell a particular item.
(c) The party that buys the rights to sell or produce and sell any item under the contract of franchise is known as franchise.

22.7 2. (a) Direct marketing (b) Telemarketing
(c) Internet Marketing (d) Automatic vending machine

DO AND LEARN

1. Visit at least 5 retail shops in your locality and record the following to have a clear information.
   (a) Name of the store if any.
   (b) Location of the store.
   (c) Variety of products being sold.
   (d) Place of procurement of the products (whether from wholesalers or producers).
   (e) Transportation used.
   (f) After sales service, if any provided.
   (g) Any information that the retailer pass on to the wholesalers/producers.
   (h) Any other relevant information.
2. Identify at least twenty different retail shops of your locality and classify them according to the different types you learnt in this lesson. Prepare a chart.

ROLE PLAY

Satish, the younger brother of Suresh came to Delhi for the first time. Suresh took him around Delhi to see the place. He was amazed to see the shopping complexes and the market places.

One day Suresh along with his mother had to go for monthly purchases. He took Satish along with them. Following is the conversation among them.

Satish : Bhaiya, I think it will take a whole day.
Suresh : Why do you say that?
Satish : You have to buy things of variety and that too for a whole month.
Suresh : So what?
Satish : It is going to be a tiring day.
Suresh : Why?
Satish : Naturally we will have to go different shops to buy the variety of things that we need.
What about our food? We will have to carry the things and look for lunch too?
Suresh : Don't worry brother! Have you ever heard of Departmental Store?
Satish : What? Departmental store? What is that?
Suresh : Well! Let me explain.

You are required to continue the conversation while assuming the role of Suresh and explain to Satish all about Departmental Store.

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23

EXTERNAL TRADE

With the development of human society and progress in science and technology, the scope of trade has also widened. It has now crossed the geographical boundaries of each country. Today, we can buy goods of our need from other countries and also sell our surplus goods abroad without facing much difficulty. When the business firms of two different countries participate in the process of buying and selling of goods it is termed as External Trade. Now you think yourself, is there any difference in the nature and procedure of this type of trade from the type of trade about which you have already learnt in the previous lesson?

Now let us try to find out the answer to such questions.

OBJECTIVES

After studying this lesson, you will be able to:

- define the term 'external trade';
- describe the importance of external trade;
- identify the different types of external trade;
- explain the various difficulties faced in external trade;
- state the various documents used in external trade;
- explain the procedure for import and export of goods and
- describe the various export promotion measures undertaken by the government.

23.1 EXTERNAL TRADE – MEANING

You know that no country in the world possesses everything that is needed by its people. So they all have to depend on others to meet their requirement of certain items. For example, a country may be rich in iron and steel but poor in aluminium. So it has to meet its requirement of aluminium from countries with surplus production of aluminium. Not only that, the countries having excess production of certain items find it beneficial to sell them to some other countries and buy items in which they are deficient from others. It is also observed that some countries attain specialisation in production of certain products by virtue of adopting advanced technology while others find it difficult or expensive to produce it in their own country. They prefer to buy those products from the former. Thus, uneven distribution of natural resources and specialisation attained in production of certain items give rise to exchange of goods and services between different countries. Such exchange is termed as "External Trade". It is also known as Foreign Trade or International Trade.

> When buying and selling of goods take place across the national boundaries of different countries it is called External trade. It is also known as Foreign trade or International trade.

23.2 TYPES OF EXTERNAL TRADE

On the basis of sale and purchase of goods and services, external trade can be divided into three kinds. These are:

(a) Import trade (b) Export trade (c) Entrepot trade

Let us discuss in detail about them.

(a) **Import Trade :** When the busness firm of a country purchases goods from the firm of another country, it is called Import trade. For example, when India Govt. purchases petroleum products, electronic goods, gold, machineries, etc., from other countries it is termed as import trade.

(b) **Export Trade :** When the firm of a country sells goods to a firm of another country, it is called Export trade. For example, the sale of iron and steel, tea, coffee, coal, etc. by Indian companies to other countries is known as its export trade.

(c) **Entrepot Trade :** When the firm of a country imports goods for the purpose of exporting the same to the firms of some other country with or without making any change, it is known as entrepot trade or re-export trade for that country. For example, if an Indian company imports rubber from Thailand and exports it to Japan then it is called Entrepot trade for India. Now you must be thinking, why India comes between Thailand and Japan. Why doesn't Japan directly imports rubber from Thailand? Let us see what could be the possible reasons for this.

A country cannot import goods directly from others because of the following reasons:

- The exporting country may not have any accessible trade routes connecting the importing country; or
- The goods imported may require processing or finishing before exporting. And these facilities may be lacking in the exporting or importing countries;
- There may not be any trade agreement between both the countries.

Visible and Invisible Trade

Visible trade refers to imports and exports of tangible goods, whereas invisible trade of a country includes services received from other countries or services rendered to other countries. Shipping and insurance services, services to foreign tourists, services of foreign technicians, interest on loans etc., are some of the example of invisible trade.

23.3 IMPORTANCE OF EXTERNAL TRADE

External Trade is an important indicator of economic condition of a nation. Both importing and exporting countries are benefited by external trade. While exporting country earns more foreign exchange by exporting its surplus, the importing country at the same time gets the opportunity to use better products and raise the standard of living of its people. Let us discuss in details about the importance of external trade.

(a) **Promotes Specialisation :** External trade promotes specialisation. When there is expansion in the demand for a particular commodity, its producer is encouraged to specialise in its production. For example, there is demand of Japanese electronic goods all over the world. The result is that Japan's efficacy in this field has developed enormously. Similarly our country has specialised in tea, coffee and sugar production.

(b) **Improves Standard of Living :** On account of import trade, a country can consume goods, which it does not produce. On the other hand, it earns foreign exchange through export trade. The import and export trade thus, help in raising standard of living of a country.

(c) **Enhances Competition :** External trade enhances competition, which compels the domestic firms to improve technology of production, production process and quality of the products. It ultimately benefits the consumers in getting better quality products at competitive prices. It also provides a large variety of goods.

(d) **Generates Employment Opportunities :** External trade facilitates the growth of agricultural, commercial as well as industrial activities, which in turn generates more and more employment opportunities for the people.

(e) **Price Equalisation :** External trade leads to equalisation of prices of goods and commodities in the world. Whenever the prices of commodities tend to rise because of short supply it can be checked by importing more goods. Similarly when the prices of products decline because of availability of excessive item, the country may export that surplus to others.

(f) **International Relation :** External trade brings the people of two different countries to come closer and to understand the need and requirement of each other. They also participate in various trade and cultural exhibitions. All these activities promote harmonious and cordial relationship among the nations.

(g) **Economic Growth :** Economic growth of every country depends to a large extend on the volume of external trade. If a country specialises in any product, it needs to produce more to meet the worldwide demand. So by producing and exporting more goods and services it can accelerate the economic growth of the country.

(h) **Proper Utilisation of Natural Resources :** External trade is a means through which the natural resources of various countries can be properly utilised. For example, a country may be rich in minerals but due to lack of technological advancement it is not able to extract those minerals from the earth. So it can import modern equipments and machineries from advanced countries and make proper utilisation of those natural resources.

INTEXT QUESTIONS 23.1

1. Mention any two reasons for 'entrepot trade'.
2. How does external trade improves the standard of living of the people?
3. State whether there is Export trade, Import trade or 'Entreport trade' in the following cases pertaining to India.
   (a) India purchased petroleum products from a foreign company.
   (b) USA sold Engineering products to India.
   (c) India bought goods from Russia and sold to Sri Lanka.
   (d) UK bought jewellery/gold items/pearls from India.
   (e) Germany bought Telecom services from India.

23.4 DIFFICULTIES FACED IN EXTERNAL TRADE

In internal trade generally buyers and sellers meet together and transactions take place as per their convenience. But in external trade the situation is completely different. It takes a long procedure to buy and sell the goods and services. The business people generally face a number of problems in the process of foreign trade. The various difficulties, which are faced by the buyers and sellers engaged in external trade are discribed below.

(a) **Distance :** External trade involves transport of goods over long distances, except for neighbouring countries. Distance between various countries makes it difficult to establish quick and close trade contact between the importers and exporters.

(b) **Greater Risk :** In external trade goods are exposed to greater degree of risk. Risk in transit of goods is more because of long distance. Goods are transported by ship, which may sink due to storm or collide with submerged rocks. The ships or goods may also be captured by the enemies. These risks may be covered through marine insurance, but that increases the cost of goods.

(c) **Difficulties of Transport and Communication :** Long distances incidental to external trade create difficulties of proper and quick means of transport and communication. Though modern means of communication have solved this problem, it is quite costly and can not be used for securing all sorts of information. Loading and unloading of goods often takes long time and also involves large expenses which increases the cost of goods.

(d) **Restrictions :** External trade is subject to various restrictions by way of customs, tariff, quotas and exchange regulations, which restrict the scope of external trade.

(e) **Lack of Personal Touch :** In external trade, the transactions are made with unknown persons through correspondence and other means of communication. There is no direct contact between the buyer and seller. So the risk of dispute and bad debts are always there.

(f) **Study of Foreign Markets :** Markets for different products have their own characteristics as regards demand, intensity of competition, buyers' preferences, etc. Thus, an extensive study of foreign markets is required for success in external trade. This is not easily possible from an individual exporter's or importer's point of view.

(g) **Cost :** Both import and export of goods involve very costly operations due to high cost of transport, insurance, intermediaries and cost of formalities to be completed.

(h) **Change in Rules and Regulations :** Every country has framed its own rules and regulations for its external trade, to protect its economic and political interest. These rules change from time to time. So the traders find it difficult to acquaint themselves with the rules and regulations and procedures followed by different countries.

(i) **Frequent Price Change :** In external trade the price of the product changes frequently due to change in foreign exchange rate, change in import and export duties etc.

By foreign exchange rate we mean, the rate at which a unit of currency of a particular country is exchanged with a unit of currency of a foreign country. For example, the exchange rate of Indian rupee and US dollar is 61.13 INR as on April, 09, 2011. This rate keeps on changing according to fluctuations in the purchasing power of the foreign currency. You are requested to find out the present exchange rate of Indian currency and American dollar. One US$ = Rs. _____ as on ________.

23.5 FACILITATORS OF EXTERNAL TRADE

In the previous section we discussed about some of the problems and difficulties which are faced by the importers as well as exporters. After knowing all these do you think that the traders will alone be able to carryout the business successfully. The answer is obviously NO. The traders need support from others in the process of buying and selling. The persons or institutions that provide various kinds of support are termed as facilitators of external trade. Let us learn about some of such facilitators.

1. **Indent Houses/Indent Firms :** They help importer and exporter in sending and receiving the order of goods along with other instructions.
2. **Export Houses :** These are organisations involved in export promotion activities, such as STC, MMTC, Handicrafts and Handloom Export Corporation (HHEC) and Central Cottage Industries Corporation (CCIC) etc.
3. **Forwarding Agents :** They act on behalf of exporters to complete all the formalities of loading the goods on the ship.
4. **Clearing Agents :** Clearing agents act on behalf of the importer and complete all formalities required for clearing the goods from the port of destination. He takes delivery of the goods from the customs authority and sends the goods by rail/road to the place of importer.
5. **Shipping Company :** It carries goods on payment of freight charges, and undertakes to deliver the same to the importer.
6. **Insurance Company :** It bears the loss or damage to the goods against insured risks right from the godown of the exporter to the godown of the importer.
7. **Trade Commissioners :** These officials are appointed by the government in its embassy to represent the country's trade-interests abroad. They collect information relating to trade relations and disseminate the same among traders. They also advise the traders on matters relating to imports and exports.
8. **Trade Representatives :** These officials provide guidance to exporters abroad on behalf of the government of their own country. They make efforts to secure payment for goods and also advise on legal matter s.

INTEXT QUESTIONS 23.2

1. How can a clearing agent help the importer?
2. State any four difficulties faced by buyers and sellers in External trade.
3. Match the following facilitations.

Column I		Column II	
(a)	Export Houses	(i)	Carries goods on payment of freight charge.
(b)	Indent Houses	(ii)	Agent ready to bear the loss/damage.
(c)	Clearing Agents	(iii)	Organisation involved in Export promotion activities.
(d)	Shipping Company	(iv)	Help in receiving orders to goods with in structions.
(e)	Insurance Company	(v)	Complete all formalities for clearing goods from destination.

Essential Requirements for Exporter and Importer

If you want to start an export-import business then first you have to obtain the following legal documents.

1. ***Import Export Code (IEC) Number :*** The IEC number is granted by the Director General of Foreign Trade. Every firm dealing with export-import business must obtain this number without which no documents relating to external trade will be forwarded.

2. ***Registration-cum-Membership Certificate (RCMC) :*** Government provides certain facilities and benefits to the exporters and importers under its EXIM policy. To avail such facilities every firm must obtain the Registration-cum-Membership Certificate from the appropriate export promotion council. Export promotion councils are different organizations set up by the Government to promote and develop exports of different categories of products.

23.6 PROCEDURE FOR EXPORT TRADE

The procedure generally adopted for exporting goods to a foreign country is as follows:

1. **Receipt of Enquiry and Sending Quotations :** The importer of goods first sends an enquiry to different exporters requesting them to send information about price, quality, terms of payment etc. In reply to the enquiry, the exporters then send the quotation mentioning details about the products, price, quality, mode of delivery, terms and conditions if any.

Notes

2. **Receipt of an Indent or Export Order :** If the prospective importer finds the terms and conditions acceptable, then he places an order for export of goods which is known as indent. An indent contains a description of the goods ordered, price to be paid, terms and conditions of delivery, packing of goods and other details. On receipt of indent if the exporter finds it satisfactory, then he forwards his acceptance to export the goods.
3. **Credit Enquiry :** The exporter must ensure that there is no risk of default in payment. He should verify the credit worthiness of the importer. For this purpose he may ask the importer to send a letter of credit, bank guarantee or any other guarantee.
4. **Obtaining Export Licence :** Each and every country has its own import and export policy for free goods and restricted goods. An exporter in India has to complete various formalities and apply for export license to the appropriate authority. If the authority is satisfied it will issue the export license. To get an export license, the exporter must have (i) an IEC number (ii) RCMC from appropriate export promotion council and (iii) Registration with Export Credit and Guarantee Corporation (ECGC). The registation with ECGC safeguards against risk of non-payments.
5. **Production or Procurement of goods :** The exporter has to produce the goods or buy them from the market. The goods must be in accordance with the instructions given in the indent regarding the quality, quantity, price, etc.
6. **Pre-shipment Inspection :** To ensure that only good quality products are exported from our country, the Government of India has made compulsory pre-shipment inspection of goods by certain authorised agencies .
7. **Excise Clearance :** In India, manufactured products are subject to excise duty under the Central Excise Act. Therefore excise clearance certificate is a must for the goods to be exported. It may be noted here that the Government of India has exempted excise duty in many cases if the goods are manufactured exclusively for the purpose of export.
8. **Packing and marking of the goods :** Packing should be done strictly according to the instructions given in the indent. If loss arises due to defective packing, the exporter may have to bear it. If necessary, grading should be done before packing. The packages should be properly marked according to instructions, if any, so that they may be easily recognised.
9. **Appointment of forwarding agent :** Packed goods may be despatched to the port directly by the exporter or through a forwarding agent. If the goods are stored in any location, the exporter may appoint a forwarding agent who will perform all the formalities on behalf of the exporter before shipping the goods. The forwarding agent will charge commission for this work.

10. **Despatch of goods by rail/road :** The exporter has to despatch the goods by rail/road to the port town. He will send the R/R (railway receipt) to the forwarding agent along with other instructions. The agent will take delivery of the goods and complete other formalities before shipping them to the importer.

11. **Formalities to be completed by Forwarding agent:**

    (a) ***Obtaining the custom permit :*** The agent has to apply to the custom office giving full details of the goods and also their destination in order to receive the custom permit. If goods are duty free then custom permit is given immediately, otherwise it will be necessary to complete other formalities.

    (b) ***Obtaining shipping order :*** The agent has to secure adequate space in the ship for loading of goods. For this purpose he has to sign an agreement with the shipping company for issue of the shipping order which will enable him to put the goods in the ship.

    (c) ***Completion of shipping bill and payment of export duty :*** The Agent has to fill in three copies of shipping bill and submit them to the custom-house. On the basis of the bill, duty is calculated by the custom authority. The agent has to make payment of the duty and get the original and third copy of the Shipping Bill from the custom authority.

    (d) ***Payment of dock dues :*** The agent has to make arrangement for carrying the goods to the dock. For this purpose, two copies of properly completed 'Dock Challan' are submitted to the dock authorities along with one copy each of shipping bill and shipping order. After dock charges are received, the dock authorities retain one copy of dock challan and return the duly signed second copy to the agent.

    (e) ***Custom's verification before loading of goods :*** As soon as the ship touches the port, the dock authorities start loading the goods on it. Before the goods are actually loaded, custom officials verify them to know if there is anything on which duty remains to be paid or which is not mentioned in the shipping bill. The captain or his assistant (mate) will receive goods only when shipping order has been produced before him.

    (f) ***Mate's receipt :*** The captain or mate will issue a receipt known as "mate's receipt" after the goods have been loaded. This receipt contains particulars like quantity of goods, number of packets, condition of packing, etc.

    (g) ***Bill of lading :*** The forwarding agent has to present the mate's receipt at the office of the shipping company and in exchange will get a document known as Bill of Lading. He has to fill in three blank forms of bills of lading

giving details regarding the goods, destination, name of the ship, date and place of loading and name and address of the person to whom delivery is to be made. If the freight is paid in advance the bill of lading is marked 'freight paid'. Otherwise it is marked 'freight forward' which means freight will be paid at the port of destination.

(h) ***Insurance of cargo :*** As a safeguard against marine risks, it is necessary to insure the goods. Insurance must be done strictly according to the instructions, if any, of the importer as given in the indent. If there is no instruction, the exporter himself should insure the goods. The insurance policy is sent to the importer along with the bill of lading and other documents.

(i) ***Advice to the exporter :*** The agent then informs the exporter about the shipment of goods and other related matters. He will send the bill of lading, insurance policy, shipping bill etc. to the exporter along with a statement showing his expenses and remuneration.

12. **Preparation of export invoice and consular invoice :** Having received the advice from the forwarding agent, the exporter prepares an export invoice known as foreign invoice. This invoice states the quantity of goods sent and amount due from the importer. Custom regulations of many countries require consular invoice for the purpose of easy clearance of goods at the port of destination in the importing country. If it is required by the importer then the exporter has to arrange for such a document also.

13. **Securing Payment :** There are two alternative methods by which payment can be received by the exporter.

(a) ***Letter of credit :*** The exporter can get immediate payment on the strength of the letter of credit which is issued by the importer's bank in favour of the exporter. The exporter has to draw the bill in order to get the payment from the local branch of the bank (in home country), which has issued the letter of credit on behalf of the importer.

(b) ***Letter of hypothecation :*** If the exporter wants to receive payment immediately, he can get the bill (accepted by the importer) discounted with his bank. But for this purpose, he has to give a letter of hypothecation to his bank. Letter of hypothecation is a letter addressed to a bank attached with the bill of exchange which is accepted by the importer. Through his letter of hypothecation, the exporter authorises the bank to sell the goods in case of dishonour of the bill by the importer so that the bank can realise the amount advanced by it to the exporter.

INTEXT QUESTIONS 23.3

1. Define 'Letter of Credit'.
2. Name the document referred to in each of the following cases.
   (a) Agreement signed with the shipping company to enable to put goods on the ship.
   (b) Document issued by the captain of the ship after loading the goods on the ship.
   (c) Assured payment on the strength of a document issued by the importers bank.
   (d) Document which authorises the bank to sell the goods in case of dishonour of bill.
   (e) Document received in exchange of Mate's Receipt at the shipping office.

23.7 PROCEDURE FOR IMPORT TRADE

The steps involved in importing goods are discussed below:

1. **Trade Enquiry :** It is a written request by the importer to the exporters for supply of relevant information regarding the price, quality, quantity and various terms and conditions of export etc. In response to the trade inquiry of the importer, the exporter prepares the quotation and sends it to the importer.
2. **Obtaining Import Licence :** An importer cannot import goods without having a valid licence from the Import Licensing Authority. In India it is compulsory to get the IEC number from the DGFT.
3. **Obtaining Foreign Exchange :** As foreign exchange transactions are controlled by Reserve Bank of India, the importer has to submit an application along with necessary documents to the Exchange Control department of RBI. After scrutinising the application, the Reserve Bank of India will sanction the release of foreign exchange.
4. **Placing the Indent or Order :** Indent is the purchase order to the exporter by an importer for specified goods. The indent may be sent directly to the manufacturer of goods or to the exporting agent.
5. **Sending Letter of Credit :** Generally, the parties in external trade are not very well known to each other. So the exporter wants to be sure of the credit-worthiness of the importer. Usually, the exporter asks the importer to send a letter of credit. An importer can get a letter of credit issued as per terms and conditions of his

banker and send it to the exporter. It ensures payment of bill of exchange drawn by the exporter upto the amount specified in the letter of credit.

6. **Procuring the Shipping Documents:** The importer will arrange to obtain necessary documents such as bill of lading, shipping bill, etc., after receiving the advice letter from the exporter. The documents are procured to take delivery of the goods. He has to go to the exporter's bank to make payment in order to get the necessary documents for taking delivery of the goods.

7. **Appointment of Clearing Agent :** The importer may take delivery on his own or appoint an agent known as clearing agent, to take delivery of the goods. The importer sends necessary documents to his agent to clear the goods. The clearing agent charges commission for his services for clearing the goods.

8. **Formalities to be Completed by the Clearing Agent :**

   (a) ***Endorsement for Delivery :*** When the ship arrives at the port, the clearing agent approaches the concerned shipping company and gets the bill of lading endorsed in his own name from the shipping company. If the freight has not been paid by the exporter, it will have to be paid before endorsement of the bill of lading.

   (b) ***Bill of Entry :*** The agent has to fill in and submit three copies of the bill of entry to the custom authority. The custom authority will calculate the duty and receive the same from the clearing agent.

   (c) ***Payment of Dock Charges :*** The agent has to complete and file two copies of Port Trust receipt and three copies of Bill of entry to the landing and shipping dues office. After receiving the dock charges, the dock authority will return one copy of Port Trust receipt and two copies of the Bill of entry to the agent. Then the agent has to submit this copy alongwith two copies of Bill of entry to the custom office. If customs duty is to be paid, he will make the payment and take delivery of the goods.

   (d) ***Despatch of Goods by Rail/Road :*** The clearing agent has to arrange carriage of the goods to the railway station or the transport authority after taking the delivery from the dock authority. He will despatch the goods by rail/road to his principal and get the railway receipt/carrier receipt.

   (e) ***Advice to the Importer :*** The clearing agent has to write a letter of advice to the importer after despatch of goods. In this letter of advice, information regarding arrival of goods and their despatch by rail/road are specified. He has to enclose with it the railway receipt/carrier receipt and a statement of his expenses and charges.

Notes

9. **Delivery of goods from Railway/Transport Authority:** The importer can take delivery of the goods from the railway or transport authority and carry them to his godown.

INTEXT QUESTIONS 23.4

1. Mention any three roles played by clearing agent in external trade.

2. Answer the following questions:

   (a) Name the specific department of RBI that controls the foreign exchange transactions.

   (b) In import trade, who sends the letter of credit to whom?

   (c) Who appoints clearing agent?

   (d) To whom is letter of advice forwarded by the clearing agent.

23.8 DOCUMENTS USED IN EXTERNAL TRADE

The main documents which are used in external trade are discussed below:

1. **Indent :** It is an order placed for import of goods. It is sent to the exporter for supply of goods. It contains full information regarding the goods to be imported i.e., quantity, quality, mode of packing and marking, period of delivery, mode of payment and other instructions regarding shipment and insurance, etc.

2. **Letter of Credit :** In external trade, the importer has to prove his credit-worthiness to the exporter, who may demand a certain amount of deposit or even full payment of due price before the shipment of goods. For this purpose, the importer arranges with his bank for issuing a letter of credit in favour of the exporter. Thus, a letter of credit is issued by a bank of the importer's country in favour of the foreign dealer. It contains an undertaking by the bank concerned that the bill of exchange drawn by the foreign dealer on the importer will be honoured on presentation to the extent of amount specified in it. Thus, it establishes the credit-worthiness of the importer and guarantees payment of price to the exporter for the goods exported by him.

3. **Bill of Lading :** It is a document prepared by the ship owner or by the master of the ship acknowledging the receipt of goods and undertaking to deliver the goods at the port of destination. This, on one hand, acts as a proof of the receipt of goods specified there in and on the other, is a document of title to the goods. The document is sent by the exporter to the importer who can take delivery of the goods at the port of destination on presentation of the bill of lading and other shipping documents.

4. **Advice Letter :** It is a document, which is prepared by the forwarding agent and sent to the exporter indicating that all the formalities for export of goods have been completed and goods have been shipped. Along with this letter, the forwarding agent sends a statement showing expenses incurred on the goods exported and his remuneration. Similarly, a letter of advice is also prepared by the clearing agent and sent to the importer stating that all the formalities for clearing the imported goods have been completed. Along with this letter, the clearing agent sends the railway receipt as a proof of goods sent to importer as well as his statement of account for expenses incurred and commission charged. Thus, it is a document used both in export and import trade.

5. **Documentary Bill :** When the documents of title to goods are sent along with the bill of exchange drawn by the exporter on the importer, it is called a documentary bill. It may be of two types (a) Documentary bill against payment (b) Documentary bill against acceptance. In case of documentary bill against payment, the documents of title to exported goods are delivered to the importer only when the importer has paid the amount specified in the bill of exchange. In case of documentary bill against acceptance, the documents of title to the exported goods are delivered to the importer after he has accepted the bill of exchange drawn by the exporter.

6. **Insurance Policy :** The insurance policy is issued by the insurance company to cover the risks of loss or damage to goods due to specified causes. If there is no insurance then the loss will have to be borne by the owner of the goods, the exporter or importer. Under CIF (Cost Insurance Freight) contract, insurance is generally done by the exporter while under FOB (Free on Board) contract, insurance is done by the importer. There are different types of insurance policies to cover different types of risks in external trade.

7. **Shipping Order :** In order to hire space in the ship, the exporter or his agent has to enter into an agreement with the shipping company. The shipping company on the conclusion of the agreement gives a shipping order, which contains instruction to the captain of the ship to receive on board the specified quantity of goods from the exporter.

8. **Shipping Bill :** The shipping bill is a document prepared by the exporter, or the forwarding agent on the basis of which the custom authority calculates the duty to be paid by the exporter.

9. **Mate's Receipt :** When goods are brought to the docks for shipment, the document issued by the dock authority is known as a dock receipt. It is the duty of the dock authority to load the goods in the ship. But if goods are directly taken into the ship, the captain or his assistant (mate) gives a receipt as a proof of goods loaded in the ship. This receipt is known as Mate's receipt. If the mate is not satisfied regarding the packing of goods, he issues a foul Mate's receipt, otherwise he issues a clean Mate's receipt.

10. **Dock Challan, Dock Warrant and Dock Receipt :** The exporter has to fill up a form for the payment of dock charges. This form is known as 'Dock Challan'. After paying the dock charges, a document is issued permitting the goods to be brought to the docks for loading. This document is known as Dock Warrant. After the goods are actually brought to the docks and handed over to the dock authority for loading in the ship, the document issued as a proof of delivery is known as Dock Receipt.

11. **Consular Invoice :** The exporter fills up a special invoice form mentioning all the particulars about the goods shipped and certifying the accuracy of the prices shown. This invoice is signed by the consul of the importer's country stationed in the exporter's country. This special invoice is known as Consular invoice. This document is obtained to avoid under and over invoicing as well as for easy clearance of goods by the custom authority at the importer's country.

12. **Certificate of Origin :** It is a document issued as a proof of the fact that the goods have been produced in the country mentioned on it, i.e., a certificate about the genuine origin of the goods exported. This document is issued on the basis of trade agreements between the countries in which they agree to levy lower rates of import duties on the goods produced by them. Some chambers of commerce are authorised to issue such certificates.

13. **Airway Bill :** When goods, especially perishable ones, are sent to the importer by air, then this document is needed. It is a receipt given by the airline authority for the goods it is carrying. At the destination it has to be surrendered by the importer for releasing goods. It contains such information as name and address of exporter, name and address of importer or his agent, description of goods, number of packages, weight and volume of goods, rate of freight and total freight, airport of loading and destination, flight number and date, etc.

14. **Export Invoice/Foreign Invoice :** The foreign invoice is prepared by the exporter and he/she sends it to the importer after the shipment of goods. This invoice contains details such as the name of the ship, port of shipment, port of destination, number of indent, details regarding packing and marking, price of goods and other expenses including freight, dock dues and insurance charges.

15. **Bill of Entry :** Bill of entry is a form to be filled up by the importer at the time of receiving the goods. It is a document based on which imported goods are cleared from the port. These are two types of bill of entry.

    (a) ***Bill of entry for Home Consumption :*** Where an importer wants to get his goods cleared in one lot, he has to present the bill of entry for home consumption.

(b) ***Bill of entry for Warehousing :*** Where an importer wants to shift the goods to warehouse and thereafter get his goods cleared in small lot, he has to present the bill of entry for warehousing. Reason may be that he is unable to pay duty on all goods in one instalment or because he has a storage problem.

For imports through post, no bill of entry is used. Instead a way bill is prepared by Foreign post office for ascertainment of duty.

INTEXT QUESTIONS 23.5

1. What is meant by Consular Invoice?

2. Arrange the following document in proper sequence.

   (a) Dock Receipt

   (b) Dock Challan

   (c) Dock Warrant

3. Answer the following in a word or phrase.

   (a) The document prepared by the master of the ship acknowledging the receipt of goods.

   (b) The document issued as a proof of the fact that goods have been produced in the country mentioned on it.

   (c) The document forwarded by the exporter to the importer after the shipment of goods.

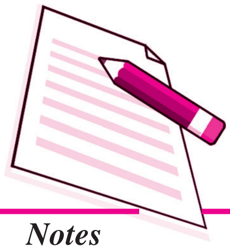
   (d) The document issued by the dock authority after receiving the goods from the exporters.

   (e) The document needed in sending goods by air.

   (f) Document which acts as a proof that goods of stated value and quantity are being brought into the country from abroad.

23.9 WORLD TRADE ORGANISATION

The Eighth Uruguay Round was successful and led to the setting up of the WTO. The WTO, was launched on January 1, 1995 replacing the GATT. Naturally, the GATT members became the members of WTO. It administers the agreements contained in the Final Act of the Uruguay Round. At present WTO consists of 148 members.



Notes

As the name suggests, GATT was meant to deal with tariffs and other trade restrictions and prescribe rules for international trade. The removal of trade barriers was sought to be achieved through negotiations among the GATT members. In all GATT had seven rounds of prolonged negotiations, the last one being the Uruguay Round, whcih was launched in September 1986 and concluded in Decemebr 1993. These negotiations covered not only the traditional subjects such as tariffs and non-tariff restrictions, but also extended to cover seven broad areas, viz., (i) market access, (ii) agriculture, (iii) textiles, (iv) trade related intellectual property rights (TRIPS), (v) trade related investment measures and services (TRIMS), (vi) trade in services, and (vii) institutional matters. While negotiations on the various aspects of trade related matters were concluded quite successfully by the GATT, it was however realised that the GATT did not have any mechanism for resolving trade disputes among the member nations. Consequently any powerful member could veto any decision arrived at by the organisation and impose its will on the small member countries. Thus, an organisation was required which could provide a level playing field to all the members and resolve trade disputes with authority and equity. This led to the establishment of the World Trade Organisation (WTO), which offers a far more powerful mechanism for resolving disputes in international trade.

Objectives of WTO

i. Raising standard of living

ii. Employment generation.

iii. Optimal use of world resources.

iv. Sustainable development.

v. Ensuring that LDC (Least Developed Countries) secure a better share of growth in international trade.

Role of WTO

WTO has been playing an important role in facilitating and promoting international trade. The following points sum up the role of WTO:

i. WTO facilitates international business and promotes international peace.

ii. It has reduced barriers in the conduct of international trade.

iii. WTO agreements have made international trade and relations very smooth and predictable.

iv. Free trade improves the living standard of the people by increasing their income level.

v. Free trade provides ample scope of getting varieties of qualitative products.

vi. Economic growth has been speeded up because of free trade.

vii. WTO helps fostering growth of developing countries by providing them with special and preferential treatment in trade related matters.

WHAT YOU HAVE LEARNT

- Meaning of External trade : When buying and selling of goods take place across the national boundaries of different countries it is called External trade. It is also known as Foreign trade or International trade.

- **Kinds of External Trade**

  - ***Import trade*** - A firm purchases goods and services from another country
  - ***Export trade*** - A firm sells goods and services to another country
  - ***Entrepot trade*** - A firm imports goods in order to export the same to another country.

- Importance of External trade: A country earns foreign exchange by exporting its surplus and while importing gets the opportunity to use better products and technology. Some of the points of importance are:

  - Promotes specialization
  - Improves standard of living
  - Enhances competition
  - Generates Employment opportunities
  - Price equalisation
  - International Relation
  - Economic Growth
  - Proper utilisation of natural resources.

- Difficulties faced in External Trade : It is generally accompanied by many problems, as listed below.

  - Distance
  - Lack of personal touch

- Greater risk
- Study of foreign markets
- Difficulties of transport and communication
- Cost
- Restrictions
- Frequent price change
- Changes in rules and regulations.

- **Facilitators of External Trade :** The traders need the support of others in the process of buying or selling in External Trade. Some of them are Indent house, Export house, Forwarding, Clearing Agents, Shipping Company, Insurance Company Trade Commissioners and Trade Representatives.
- **Essential requirement for Exporters/Importers :** (i) IEC number; and (ii) RCMC.
- **Procedure for Export Trade**
  - Receipt of enquiry and sending quotations
  - Receipt of indent or export order
  - Credit enquiry
  - Obtaining Export license
  - Production or procurement of goods
  - Packing and Marking of goods
  - Appointment of Forwarding Agent
  - Despatch of goods by rail/road
  - Formalities to be completed by Forwarding Agent
  - Preparation of Export Invoice and Consumer Invoice
  - Securing payment
  - Letter of Credit
  - Letter of Hypothecation
- **Procedure for Import Trade**
  - Trade enquiry
  - Obtaining import license
  - Obtaining foreign exchange
  - Placing the indent or order

Notes

- Sending Letter of Credit (Loc)
- Procuring the shipping documents
- Appointment of Clearing Agent
- Formation completed by Clearing Agent
- Delivery of goods from Railway/Transport authority

- **Documents Used in External Trade**

  - Indent
  - Letter of Credit
  - Bill of Lading
  - Advice Letter
  - Documentary Bill
  - Insurance Policy
  - Shipping order
  - Shipping bill
  - Mates Receipt
  - Dock challan etc.
  - Consular Invoice
  - Certificate of origin
  - Airway bill
  - Export Invoice/Foreign Invoice
  - Bill of Entry

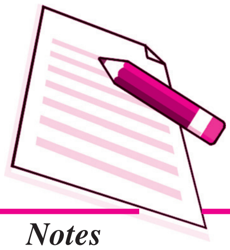
KEY TERMS

Advice Letter	Bill of Entry	Bill of Lading
Clearing Agent	Consular Invoice	Dock Challan
Dock Receipt	Dock Warrant	Documentary Bill
Foreign Invoice	Forwarding Agent	IEC number
Indent	Invisible Trade	Letter of Credit
Mate's Receipt	Shipping Order	Special Economic Zones

TERMINAL EXERCISE

Very Short Answer Type Questions

1. What is meant by External Trade?
2. Name the different types of External trade.
3. What is meant by Entreport trade?



Notes

4. Give two reasons for the importance of External trade.
5. Name any two promotion measures for Export trade.

Short Answer type Questions

6. Explain 'packing and marking' of the goods in external trade.
7. Explain the two alternative methods of payment to the exporter.
8. What is meant by 'Letter of Credit'?
9. What are (i) Bill of Lading, (ii) Shipping order and (iii) Mate's receipt.

Long Answer type questions

10. Explain the various measures taken up by Government of India to facilitate exports.
11. Discuss the various documents used in External Trade.
12. Advise Suresh, the procedure to import ball pens from Japan.
13. Satish wants to export leather goods to Singapore. You are required to explain to him the procedure for the same.
14. Explain the need and importance of external trade to the Indian Economy.

ANSWERS TO INTEXT QUESTIONS

23.1 2. (a) Import (b) Import (c) Entrepot (d) Export (e) Export

23.2 3. (a) iii; (b) iv; (c) v; (d) i; (e) ii

23.3 1. (a) Shipping order (b) Mate's Receipt (c) Letter of credit (d) Letter of Hypothecation (e) Bill of Lading

23.4 2. (a) Exchange control department
(b) Importer sends the letter of credit to exporter
(c) Importer
(d) Importer

23.5 2. (a) Dock challan (b) Dock warrant (c) Dock Receipt

3. (a) Bill of Lading (b) Certificate of origin (c) Export Invoice/Foreign Invocie (d) Dock Receipt (e) Airway Bill (f) Bill of Entry

DO AND LEARN

You are required to survey the nearby area and record the observation of the following:

(a) The goods and services that are not available and you think can be imported.

(b) Find out what are the speciality goods of your local area that can be exported to boost the foreign exchange of our country.

ROLE PLAY

Gaurav was importing goods from USA and was a very accomplished and successful businessman. One day he met his friend Sanjeev who was also into the same business but not very successful. Read the conversation between them as given below.

Gaurav : Hello Sanjeev! How are you?

Sanjeev : Fine, but as usual very busy.

Gaurav : You seem to have no time for your family and friends.

Sanjeev : I am disturbed because I am not able to manage my firm well.

Gaurav : Why, what do you think is the reason?

Sanjeev : I do the running around all by myself. Sometimes I go for obtaining foreign exchange, sending letter of credit, I run for shipping documents. If find it impossible to meet all ends.

Gaurav : Remember when you try to do everything by yourself you end up doing nothing. What I feel is you must appoint an expert for carrying out certain functions. Half of your job will be done by him. Then you can relax and concentrate on other needs of your business.

Sanjeev : You said experts, handling functions? Could you elaborate that?

Gaurav : Now you see, if you appoint a Clearing Agent by paying him commission for his services he will complete the formalities like Endorsement for delivery, payment of dock charges etc.

Now continue the conversion as Gaurav explains the role of clearing agent to Sanjeev.

24

CONSUMER PROTECTION

We buy a variety of goods and services in our day-to-day life. Whatever we buy we pay for it and derive satisfaction from its consumption and use. But sometimes we do not feel satisfied with the product we buy. This may be on account of poor quality of the product, overcharging by the shopkeeper, lower quantity of contents, misleading advertisement, and so on. Should we allow these practices to continue? Obviously not; then is there any remedy for such malpractices? The answer lies in the concept and practice of consumer protection, the rights and responsibilities of consumers, legal provisions and mechanism for settlement of consumer grievances. In this lesson, let us know details about all these points.

OBJECTIVES

After studying this lesson, you will be able to:

- state the meaning of consumer;
- explain the concept of consumer protection;
- outline the need for consumer protection;
- describe the rights and responsibilities of consumers;
- state the main provisions of Consumer Protection Act; and
- outline the machinery for settlement of consumer grievances.

24.1 MEANING OF CONSUMER

You have learnt that a consumer is a person who consumes or uses any goods or services. Goods may be consumables like wheat flour, salt, sugar, fruit etc. or durable items like television, refrigerator, toaster, mixer, bicycle etc. Services refer to items like electricity, cooking gas, telephone, transportation, film show etc. Normally, it is the consumption or use of goods and services that makes the person to be called as 'consumer'. But in the eyes of law, both the person who buys any goods or hires any service for consideration (price) and the one who uses such goods and services with the approval of the buyer are termed as consumers. For example, when your father buys apple for you and you consume them, your father as well as yourself are treated as consumers. The same thing applies to hiring a taxi to go to your school. In other words, even the buyer of goods and services whether he uses them himself or purchases them for consumption or use by some other person(s) is treated as consumer in the eyes of law. However, a person who buys goods for resale (like wholesaler, retailer, etc.) or for any commercial purpose is not treated as consumer.

Under the Consumer Protection Act 1986, the word **Consumer** has been defined separately for the purpose of goods and services.

(a) For the purpose of goods, a consumer means (i) one who buys any goods for consideration; and (ii) any user of such goods other than the person who actually buys it, provided such use is made with the approval of the buyer.

(The expression 'consumer' does not include a person who obtains such goods for resale or for any commercial purpose.)

(b) For the purpose of services, a consumer means (i) one who hires any service or services for consideration; and (ii) any beneficiary of such service(s) provided the service is availed with the approval of such person.

24.2 CONCEPT OF CONSUMER PROTECTION

Consumer protection means safeguarding the interest and rights of consumers. In other words, it refers to the measures adopted for the protection of consumers from unscrupulous and unethical malpractices by the business and to provide them speedy redressal of their grievances. The most common business malpractices leading to consumer exploitation are given below.

(a) Sale of adulterated goods i.e., adding something inferior to the product being sold.

(b) Sale of spurious goods i.e., selling something of little value instead of the real product.

(c) Sale of sub-standard goods i.e., sale of goods which do not confirm to prescribed quality standards.

(d) Sale of duplicate goods.

Notes

(e) Use of false weights and measures leading to underweight.

(f) Hoarding and black-marketing leading to scarcity and rise in price.

(g) Charging more than the Maximum Retail Price (MRP) fixed for the product.

(h) Supply of defective goods.

(i) Misleading advertisements i.e., advertisements falsely claiming a product or service to be of superior quality, grade or standard.

(j) Supply of inferior services i.e., quality of service lower than the quality agreed upon.

The above instances show the exploitation of consumers in the context of goods and services. In a democratic nation like India, should we allow this to happen? So the measures adopted by the government or non-government organisations (NGOs) for safeguarding the interests of the consumers constitute consumer protection.

Examples of Consumer Exploitation in India

- *The after sales service provider of the television set charged Rs 200 as service charge though he repaired the set within the warranty period.*
- *The tickets issued to different passengers on the same day for the same journey showed the same seat number.*
- *Penalty of Rs. 50 was charged by SBI after issuing the cheque book to the customer showing that the balance available in the account was less than the minimum required balance for issue of cheque book.*
- *The supply of cooking gas cylinder to the consumers is found to be underweight.*

24.3 NEED FOR CONSUMER PROTECTION

The necessity of adopting measures to protect the interest of consumers arises mainly due to the helpless position of the consumers. There is no denying fact that the consumers have the basic right to be protected from the loss or injury caused on account of defective goods and deficiency of services. But they hardly use their rights due to lack of awareness, ignorance or lethargic attitude. However in view of the prevailing malpractices and their vulnerability there to, it is necessary to provide them physical safety, protection of economic interests, access to information, satisfactory product standard, and statutory measures for redressal of their grievances. The other main arguments in favour of consumer protection are as follows:

(a) **Social Responsibility :** The business must be guided by certain social and ethical norms. It is the moral responsibility of the business to serve the interest of consumers. Keeping in line with this principle, it is the duty of producers and traders to provide right quality and quantity of goods at fair prices to the consumers.

(b) **Increasing Awareness :** The consumers are becoming more mature and conscious of their rights against the malpractices by the business. There are many consumer organisations and associations who are making efforts to build consumer awareness, taking up their cases at various levels and helping them to enforce their rights.

(c) **Consumer Satisfaction :** Father of the Nation Mahatma Gandhi had once given a call to manufactures and traders to "*treat your consumers as god*". Consumers' satisfaction is the key to success of business. Hence, the businessmen should take every step to serve the interests of consumers by providing them quality goods and services at reasonable price.

(d) **Principle of Social Justice :** Exploitation of consumers is against the directive principles of state policy as laid down in the Constitution of India. Keeping in line with this principle, it is expected from the manufacturers, traders and service providers to refrain from malpractices and take care of consumers' interest.

(e) **Principle of Trusteeship :** According to Gandhian philosophy, manufactures and producers are not the real owners of the business. Resources are supplied by the society. They are merely the trustees of the resources and, therefore, they should use such resources effectively for the benefit of the society, which includes the consumers.

(f) **Survival and Growth of Business :** The business has to serve consumer interests for their own survival and growth. On account of globalisation and increased competition, any business organisation which indulges in malpractices or fails to provide improved services to their ultimate consumer shall find it difficult to continue. Hence, they must in their own long run interest, become consumer oriented.

24.4 CONSUMER PROTECTION

Importance of Consumer Protection

The following factors make consumer protection important.

Importance from consumer's point of view

1. Ignorant consumers are given information relating to consumer rights and remedies.
2. Redressel agencies support the consumer who need assistance.
3. Large number of consumers are exploited by manufacturers. Consumer protection safe guard, the consumers against unfair trade practices.
4. Sometimes inconveniences like foul smell from the industries, noise of machines etc. cannot be completely controlled. Consumer protection safeguards the consumers for such inconveniences.

Importance from business point of view

1. Social responsibility of business can be explained by providing quality goods at reasonable price.
2. Business are able to satisfy its consumers by providing right quality products. This helps them to retain its consumers and it serves the long term interest of business.
3. Government intervention may spoil the image of business if they follow unfair trade practices. Business firms which violate the laws are likely to lose customers and goodwill forever.
4. Business enterprises are morally brunt to be honest in their dealings with the public.

Therefore, Consumer protection is in the interest of business itself.

24.4.1 Consumer Awareness

A consumer who is well informed about his rights would be in a position to raise his voice against any unfair trade practices. In addition to this, an understanding of his responsibilities would enable a consumer to safeguard his interest.

Role of Consumer organisations and NGOs

There are more than 500 consumer organisations in India. Many of them are working as Non-governmental organisations (NGOs). Consumer organisations are voluntary associations of consumers. Consumer organisation/Non-governmental Organisations protect the consumers from being exploited from business. The role of these organisations is described below.

1. To educate consumers about their rights and responsibilities.
2. To inform consumers about the remedies available to them protecting their rights.
3. To organise exhibitions on adulterated products.
4. To arrange talks, seminars, conferences on issues relating to consumers.
5. To publish journals on consumer affairs.
6. To produce films on food adulteration.
7. To run counseling and guidance centers for consumers.
8. To file suits, complaints and write petitions before the courts on behalf of consumers.

Notes

INTEXT QUESTIONS 24.1

1. Give five instances of your daily life in which you see yourself as a consumer.

2. Put (√ / X) mark in the box provided to identify consumer exploitation.

   (a) Turmeric powder sold with mixture of yellow colour.

   (b) Purchased a table fan with two years warrantee.

   (c) Sale of noodles, marked on the label as 100 gms, but actually it weighs 80 gms.

   (d) A passenger traveled in a deluxe bus but the seat was very much uncomfortable.

3. Choose the correct answer :

   i. Mr. Babu bought a packet of fried chips manuctured by 'Sneha Confectionaries' from local retailer. On opening the packet, he found that chips were stale and foul smell emitted from it. Name the organisation which can act on behalf of Mr. babu, to protect his interest.

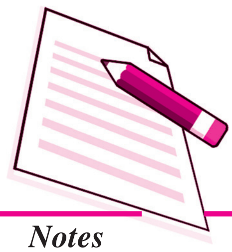
   a) Tata Consultancy Service b) Reliance Ltd.

   c) Non-governmental organisations d) None of the above

24.5 RIGHTS OF CONSUMERS

John F, Kennedy, the former USA President, in his message to consumer had given six rights to consumers. These rights are (i) right to safety, (ii) right to be informed, (iii) right to choose, (iv) right to be heard, (v) right to redress and (vi) right to represent. These rights had paved the way for organised consumer movement in the USA and later it spread all over the world. In India, the Consumer Protection Act, 1986 has also provided for the same rights to consumers. Let us have a brief idea about these rights of consumers.

(a) Right to Safety : It is the right of the consumers to be protected against goods and services which are hazardous to health or life. For example, defective vehicles could lead to serious accidents. The same is true of electrical appliances with sub-standard material. Only recently, there were mass protests and boycott of soft drinks due to presence of hazardous pesticides beyond permissible limits. Thus, right to safety is an important right available to the consumer which ensures that the manufacturers shall not produce and sell sub-standard and dangerous products.



Notes

(b) **Right to be Informed :** The right to be informed is an important component of consumer protection. The consumer must be provided with adequate and accurate information about quality, quantity, purity, standard and the price of the goods and services. Now-a-days the manufacturers provide detailed information about the contents of the product, its quantity, date of manufacturing, date of expiry, maximum retail price, precautions to be taken, etc. on the label and package of the product. Such information helps the consumers in their buying decision and use of the product.

(c) **Right to Choose :** The right to choose provides that the consumer must be assured, whenever possible, access to a variety of goods and services at competitive prices. If the market has enough varieties of products at highly competitive prices, the buyers have an opportunity of wide selection. However, incase of monopolies like railways, postal service and electricity supply etc. it implies a right to be assured of satisfactory quality of service at a fair price.

(d) **Right to be Heard :** The rights to safety, information and choice will be frivolous without the right to be heard. This right has three interpretations. Broadly speaking, this right means that consumers have a right to be consulted by Government and public bodies when decisions and policies are made affecting consumer interests. Also, consumers have a right to be heard by manufactures, dealers and advertisers about their opinion on production, marketing decisions and any grievances of the consumers. Now-a-days, most of the top manufacturers and firms have set up consumer service cells to attend to consumers' complaints and take appropriate steps for their redressal. Thirdly, consumers have the right to be heard in legal proceedings in law courts dealing with consumer complaints.

(e) **Right to Seek Redressal :** The consumers have been given the right of redressal of their grievances relating to the performance, grade, quality etc. of the goods and services. If required, the product must be repaired / replaced by the seller/ manufacturer. The Consumer Protection Act has duly provides for a fair settlement of genuine grievances of the consumers. It has also set up a proper mechanism for their redressal at district, state and national levels.

(f) **Right to Consumer Education :** It means the right to receive knowledge and skill to become informed consumer. In this direction the consumer associations, educational institutions and the policy makers can play an important part. They are expected to impart information and knowledge about (i) the relevant laws which are aimed at preventing unfair trade practices, (ii) the ways and means which dishonest traders and producers may adopt to deceive the consumers, (iii) insistence on a bill or receipt at the time of purchase, and (iv) the procedure to be followed by consumers while making complaints. Effective consumer education leads to an increased level of consumer awareness and help them to enforce their rights more effectively, and protect themselves against fraudulent, deceitful and grossly misleading advertisement, labeling, etc.

24.6 RESPONSIBILITIES OF CONSUMERS

You have learnt about the various rights of the consumers. Let us now have an idea about their duties and responsibilities. These include the following:

(a) **Be quality conscious :** To put a stop to adulteration and corrupt practices of the manufacturers and traders, it is the duty of every consumer to be conscious of the quality of product they buy. They should look for the standard quality certification marks like ISI, Agmark, FPO, Woolmark, Eco-mark, Hallmark etc. while making the purchases.

(b) **Beware of misleading advertisements :** The advertisement often exaggerates the quality of products. Hence, the consumers should not rely on the advertisement and carefully check the product or ask the users before making a purchase. Incase there are discrepancies, the same should be brought to the notice of the sponsors and the appropriate authority, if need be.

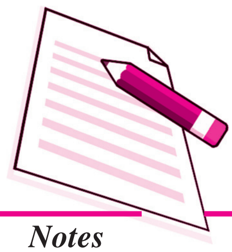
(c) **Responsibility to inspect a variety of goods before making selection :** The consumer should inspect a variety of goods before buying the goods and service. For this purpose he/she should compare their quality, price, durability, after sales service etc. This would enable the consumers to make the best choice within the limit of their own resources.

(d) **Collect proof of transaction :** The consumer should insist on a valid documentary evidence (cash memo/invoice) relating to purchase of goods or availing of any services and preserve it carefully. Such proof of purchase is required for filing a complaint. In case of durable goods the manufactures generally provide the warrantee/guarantee card along with the product. It is the duty of consumers to obtain these documents and ensure that these are duly signed, stamped and dated. The consumer must preserve them till the warrantee/guarantee period is over.

(e) **Consumers must be aware of their rights :** The consumers must be aware of their rights as stated above and exercise them while buying goods and services. For example, it is the responsibility of a consumer to insist on getting all information about the quality of the product and ensure himself/herself that it is free from any kind of defects.

(f) **Complaint for genuine grievances :** As a consumer if you are dissatisfied with the product/services, you can ask for redressal of your grievances. In this regard, you must file a proper claim with the company first. If the manufacturer/company does not respond, then you can approach the forums. But your claim must state actual loss and the compensation claim must be reasonable. At no cost fictitious complaints should be filed otherwise the forum may penalise you.

Notes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(g) Proper use of product/services : It is expected from the consumers that they use and handle the product/services properly. It has been noticed that during guarantee period, people tend to reckless use of the product, thinking that it will be replaced during the guarantee period. This practice should be avoided.

Apart from the responsibility enumerated above, the consumers should be conscious of their duty towards other consumers, society and ecology and make responsible choice. In other words, their purchases and consumption should not lead to waste of natural resources and energy and environmental pollution.

INTEXT QUESTIONS 24.2

1. What information do you expect to get under the right to consumer education?
2. Identify the relevant rights of a consumer being violated in the following instances.
   (a) A bottle of acid sold but the cap was not properly sealed.
   (b) Medicine sold without date of manufacturing and date of expiring printed on its packaging.
   (c) Madan bought a cooler with 2 years warranty. The cooler started giving problem within 6 months. Madan approached the seller. The seller did not listen to his grievances.
   (d) The seller compels the consumer to purchase the available product.
   (e) The common consumers are not aware of their rights, right path and procedure for filing the complaints.

24.7 WAYS AND MEANS OF CONSUMER PROTECTION

We have enumerated several instances of exploitations and malpractices on the part of manufacturers, traders, dealers and services providers. Now the question arises as to how can these be eliminated. Actually it is very difficult to stop such exploitation by any consumer single handedly. The consumers have to collectively act against such malpractices and take the help of consumer organisations and the government agencies. Infact, consumer protection essentially needs consumer awareness, education and guidance, and it cannot be assured by voluntary business conduct or self-regulation. The following are the various ways and means of consumer protection followed in India.

(a) Lok Adalat : Lok Adalats are the effective and economical system for quick redressal of the public grievances. The aggrieved party can directly approach the adalats with his grievance, and his issues are discussed on the spot and decisions are taken immediately. The consumers may take the advantage of this system to solve their problems. Cases of electricity billing, telephone billings, road accidents etc. can be taken up in Lok Adalat for spot settlement. Infact, Indian Railways, Mahanagar Telephone Nigam Limited and Delhi Vidyut Board hold Lok Adalat regularly to settle user's grievances on the spot.

(b) **Public Interest Litigation :** Public Interest Litigation (PIL) is a scheme under which any person can move to the court of law in the interest of the society. It involves efforts to provide legal remedy to un-represented groups and interests. Such groups may consist of consumers, minorities, poor persons, environmentalists and others. Any person or organisation, though not a party to the grievances, can approach the court for remedial action in case of any social atrocities.

(c) **Redressal Forums and Consumer Protection Councils :** Under the Consumer Protection Act 1986, a judicial system has been set up to deal with the consumer grievances and disputes at district level, state level and national level. These are known as District Forum, State Consumer Disputes Redressal Commission (State Commission) and National Consumer Disputes Redressal Commission (National Commission). Any individual consumer or association of consumers can lodge a complaint with the District, State or National level forum, depending on the value goods and claim for compensation. The main objective of these forums is to provide for a simple, speedy and inexpensive redressal of consumers' grievances. The Act as amended in 2002 also provides for setting up of **Consumer Protection Council** at district, state and national level for promotion and protection of the rights of the consumers as laid down in Section 6 of the Act. The councils are required to give wide publicity to the rights of consumers, the procedures for filling complaints by them and provide inputs to consumer movement in the country.

(d) **Awareness Programme :** To increase the level of awareness among the consumers the Government of India has initiated various publicity measures. It regularly brings out journals, brochures, booklets and various posters depicting the rights and responsibilities of consumers, redressal machineries etc. It observes World Consumer Rights Day on 15 March and National Consumer Day on 24 December. Several video programmes on consumer awareness are broadcasted through different television channels. Similarly, audio programmes are also broadcasted through All India Radio and FM channels. The poster and slogan competition on consumer protection are also organised at various level. To encourage the participation of public in the field of consumer protection the Government has also instituted National Awards to the persons who have done outstanding work in this field.

(e) **Consumer Organisations :** Consumer organisations have been active all over the world to promote and protect consumer interests. A number of such organisations have also been set up in recent years in different parts of India. It is felt that neither it is possible to discipline all members of the business community through moral sanctions and a code of fair business practices nor can administrate orders and legislative provisions to ensure consumer protection without the active involvement of consumer associations. Now with an increasing number of consumer organisations involved in consumer protection, the consumer movement is getting a foothold in India and helping individuals to seek quick and adequate redressal of their grievances. Look at the box for some of such consumer organisations.

Comsumer Organisations

Some of the important Consumer Organisations that have been playing an active role in taking up consumer cause are:

- *CERC (Consumer Education and Research Centre), Ahmedabad*
- *VOICE (Voluntary Organisation in the Interest of Consumer Education), New Delhi*
- *CGSI (Consumer Guidance Society of India), Mumbai*
- *CAG (Consumer Action Group), Chennai*
- *CUTS (Consumer Unity and Trust Society), Jaipur*
- *Common Cause, New Delhi*
- *Consumer Education Centre, Hyderabad*
- *Karnataka Consumer Service Society, Bangalore*
- *Kerela State Consumers Coordination Committee, Cochin*

These organisations are collecting data on different products and testing them, investigating into the problems of consumers, publishing and distributing brochures and journals, organising consumer awareness programmes, filing complaints, suits and writ petitions on behalf of the consumers, etc.

(f) **Consumer Welfare Fund :** The government has created a consumer welfare fund for providing financial assistance to strengthen the voluntary consumer movement in the country particularly in rural areas. This fund is mainly used for setting up facilities for training and research in consumer education, complaint handling, counseling and guidance mechanisms, product testing labs, and so on.

(g) **Legislative Measures :** A number of laws have been enacted in India to safeguard the interest of consumers and protect them from unscrupulous and unethical practices of the businessmen. Some of these Acts are as follows:

(i) Drug Control Act, 1950

(ii) Agricultural Products (Grading and Marketing) Act, 1937

(iii) Industries (Development and Regulation) Act, 1951

(iv) Prevention of Food Adulteration Act, 1954

(v) Essential Commodities Act, 1955

(vi) The Standards of Weights and Measures Act, 1956

(vii) Monopolies and Restrictive Trade Practices Act, 1969

(viii) Prevention of Black-marketing and Maintenance of Essential Supplies Act, 1980

(ix) Bureau of Indian Standards Act, 1986

The object and interest of almost all these enactments are mainly punitive, though some of these are also preventive in nature. However, none of these laws provide any direct relief to the consumers. Hence, amendments have been made in some of these laws by which individual consumers and consumer organisations have been conferred the right to take initiative and launch legal proceedings in civil and criminal courts against the violators. Another legal enactment that made a dent in this situation was the Monopolies and Restrictive Trade Practices Act, 1969. It gained the status of a specific consumer protection law with amendments made in 1984. Inspite of the changes made in 1984, a need was felt to have a more elaborate legislation. So the Consumer Protection Act was passed in 1986 to offer the necessary protection to consumers and provide an elaborate mechanism to deal with consumer grievances and disputes. A broad idea about its main provisions is being given in the next section.

INTEXT QUESTIONS 24.3

1. State the role of Consumer Protection Councils.

2. Advise Suresh to adopt the relevant Ways and Means of Consumer Protection in the following case.

   (a) Suresh had received a faulty bill from the electricity department and could not settle the matter amicably. Where should he go?

   (b) Suresh wanted to be more informed about consumer protection. What should he do?

Notes

(c) Suresh faced an accident due to the manufacturing defect in the car. He wants to claim compensation from the manufactures. Where should he go?

(d) Suresh saw a group of 30 small children aged 8 to 10 years harassed by a manufacturer who employed these children. What can he do?

(e) Suresh came to know that a Industry of the nearby area is throwing its waste into the river. What should he do?

24.8 CONSUMER PROTECTION ACT 1986

The Consumer Protection Act was passed in 1986 and it came into force from 1 July 1987. The main objectives of the Act are to provide better and all-round protection to consumers and effective safeguards against different types of exploitation such as defective goods, deficient services and unfair trade practices. It also makes provisions for a simple, speedy and inexpensive machinery for redressal of consumers' grievances.

Salient Features of Consumer Protection Act 1986

The salient features of Consumer Protection Act (CPA) 1986 are as follows:

(a) It applies to all goods, services and unfair trade practices unless specifically exempted by the Central Government.

(b) It covers all sectors whether private, public or co-operative.

(c) It provides for establishment of consumer protection councils at the central, state and district levels to promote and protect the rights of consumers and a three tier quasi-judicial machinery to deal with consumer grievances and disputes.

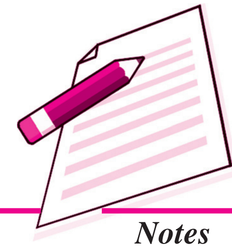
(d) It provides a statutory recognition to the six rights of consumers.

Goods and Services covered under CPA 1986

The term 'goods' under this Act has the same meaning as under the sale of goods Act. Accordingly it covers all types of movable property other than money and includes stocks and shares, growing crops, etc. The term 'service' means service of any description made available to potential users and includes banking, financing, housing construction, insurance, entertainment, transport, supply of electrical and other energy, boarding and lodging, amusement, etc. The services of doctors, engineers, architects, lawyers etc. are included under the provisions of Consumer Protection Act.

Filing of Complaints

For redressal of consumer grievances a complaint must be filed with the appropriate forum. In this section let us know, who can file a complaint, what complaints can be filed, where to file the complaint, how to file the complaints etc.



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Who can file a complaint?

The following persons can file a complaint under Consumer Protection Act 1986:

(a) a consumer;

(b) any recognised voluntary consumer association whether the consumer is a member of that association or not;

(c) the Central or any State Government; and

(d) one or more consumers where there are numerous consumers having same interest.

(e) Legal heir or representative in case of death of a consumer.

What complaints can be filed?

A consumer can file a complaint relating to any one or more of the following:

(a) an unfair trade practice or a restrictive trade practice adopted by any trader or service provider;

(b) goods bought by him or agreed to be bought by him suffer from one or more defect;

(c) services hired or availed of, or agreed to be hired or availed of, suffer from deficiency in any respect;

(d) price charged in excess of the price (i) fixed by or under the law for the time being in force, (ii) displayed on the goods or the package, (iii) displayed in the price list, or (iv) agreed between the parties; and

(e) goods or services which are hazardous or likely to be hazardous to life and safety when used.

Where to file a complaint?

If the value of goods and services and the compensation claimed does not exceed Rs. 20 lakh, the complaint can be filed in the District Forum; if it exceeds Rs. 20 lakh but does not exceed Rs. One crore, the complaint can be filed before the State Commission; and if it exceeds Rs. One crore, the complaint can be filed before the National Commission.

How to file a complaint?

A complaint can be made in person or by any authorised agent or by post. The complaint can be written on a plain paper duly supported by documentary evidence in support of the allegation contained in the complaint. The complaint should clearly specify the relief sought. It should also contain the nature, description and address of the complainant as well as the opposite party, and so also the facts relating to the complaint and when and where it arose.

Notes

What are the reliefs available to consumers?

Depending on the nature of complaint the and relief sought by the consumer, and the facts of the case, the Redressal Forum/Commission may order one or more of the following reliefs:

(a) Removal of defects from the goods or deficiencies in services in question.

(b) Replacement of the defective goods.

(c) Refund of the price paid.

(d) Award of compensation for loss or injury suffered.

(e) Discontinuance of unfair trade practices or restrictive trade practice or not to repeat them.

(f) Withdrawal of hazardous or dangerous goods from being offered for sale.

(g) Provision of adequate costs to aggrieved parties.

Time limit for filing the case

The consumer can file the complaint within two years from the date on which the cause of action had arisen. However, it may be admitted even after the lapse of two years if sufficient cause is shown for the delay.

Time limit for deciding the case

Every complaint must be disposed off as speedily as possible within a period of three months from the date of notice received by the opposite party. Where the complaint requires laboratory testing of goods this period is extended to five months.

INTEXT QUESTIONS 24.4

1. Give any two reliefs available to a consumer under the CPA 1986.

2. Write Yes or No in the following cases.

   a. Indian Airlines delayed the flight to Guwahati from New Delhi by 8 hrs. Can the passenger file a case in the consumer court?

   b. A lawyer accepted the fee but did not appear in the court for the client. Can the client approach the consumer court for remedy?

   c. Ramesh bought a refrigerator in January 2004 with a warrantee period of 2 years. In June 2005 he noticed some defect and asked the company to rectify it. The company did not listen to his complaint. Now in July 2007 he is thinking to approach the district forum for redressal. Can the forum accept his complaint?

d. In the nearby area a milkman adulterates the milk with water and sells in the locality. Can all the consumers from a group and file a case.

e. Mohan bought a product without a cash memo. Can he file a case in consumer court, if exploited?

24.9 MACHINERY FOR SETTLEMENT OF GRIEVANCES

The judicial machinery set up under the Consumer Protection Act, 1986 consists of consumer courts (forums) at the district, state and national levels. These are known as District forum, State Consumer Disputes Redressal Commission (State Commission) and National Consumer Disputes Redressal Commission (National Commission) separately. Let us have a brief idea about their composition and roles.

1. District Forum

This is established by the state governments in each of its districts.

(a) ***Composition :*** The district forums consist of a Chairman and two other members one of whom shall be a woman. The district forums are headed by the person of the rank of a District Judge.

(b) ***Jurisdiction :*** A written complaint can be filed before the District Consumer forum where the value of goods or services and the compensation claimed does not exceed Rs. 20 lakh.

(c) ***Appeal :*** If a consumer is not satisfied by the decision of the District forum, he can challenge the same before the State Commission, within 30 days of the order.

2. State Commission

This is established by the state governments in their respective states.

(a) ***Composition :*** The State Commission consists of a President and not less then two and not more than such number of members as may be prescribed, one of whom shall be a women. The Commission is headed by a person of the level of High Court judge.

(b) ***Jurisdiction :*** A written complaint can be filed before the State Commission where the value of goods or services and the compensation claimed exceeds Rs. 20 lakh but does not exceed Rs. One crore.

(c) ***Appeal :*** In case the aggrieved party is not satisfied with the order of the State Commission he can appeal to the National Commission within 30 days of passing of the order.

Notes

3. National Commission

The National commission was constituted in 1988 by the central government. It is the apex body in the three tier judicial machinery set up by the government for redressal of consumer grievances. Its office is situated at Janpath Bhawan (Old Indian Oil Bhawan), A Wing, 5th Floor, Janpath, New Delhi.

(a) ***Composition :*** It consists of a President and not less than four and not more than such members as may be prescribed, one of whom shall be a woman. The National Commission is headed by a sitting or retired judge of the Supreme Court.

(b) ***Jurisdiction :*** All complaints pertaining to those goods or services and compensation whose value is more than Rs. one crore can be filed directly before the National Commission.

(c) ***Appeal :*** An appeal can be filed against the order of the National Commission to the Supreme Court within 30 days from the date of order passed.

It may be noted that in order to attain the objects of the Consumers Protection Act, the National Commission has also been conferred with the powers of administrative control over all the State Commissions by calling for periodical returns regarding the institution, disposal and pending of cases and issuing instructions for adoption of uniform procedures, etc.

INTEXT QUESTIONS 24.5

1. State the level or rank of the head of the following consumer courts.

   (a) State Commission (b) District Forum

   (c) National Commission

2. Where does the remedy lie in the following case?

   (a) A boy got drowned in a pool and the compensation claimed is Rs. 6 crores.

   (b) The aggrieved party not being satisfied with the order of the State Commission wanted to appeal.

   (c) A builder sold a house and the land was under litigation. The consumer claimed Rs. 56 lakhs as compensation.

   (d) A consumer claimed a compensation of Rs.25,000/- from the manufacturer of a refrigerator.

   (e) The aggrieved party not being satisfied with the order of the district forum wanted to make an appeal.

WHAT YOU HAVE LEARNT

- Consumer is a person who buys goods or hires services to be used or consumed by himself/herself or by some one on behalf of the buyer.
- Consumer Protection refers to the measures adopted for the protection of consumers from unscrupulous and unethical malpractices by the business and to provide them speedy redressal of their grievances.
- A consumer will get information of consumer rights and remedies through the Consumer Protection Organisation (NGO)
- Consumer protection supports consumers and prevents exploitation of consumer.
- Consumer protections helps business to provide right quality product, increases social responsibility and prevents unfair trade practices.
- Consumer organisations and NGOs can play a vital role for consumer protection.
- Consumer organisations will educate consumers about their right through published materials, exhibitions, seminars etc.
- Consumer organisations help consumers to find remedies for their problems relating to consumer exploitation.
- The need for consumer protection arises due to the helplessness of consumers. They do not exercise their rights due to lack of awareness. Some reasons for consumer protection are:
  - Social Responsibility
  - Increasing Awareness
  - Consumer Satisfaction
  - Principle of Social Justice
  - Principle of Trusteeship
  - Survival and Growth of Business
- Rights of a Consumer as given in the Consumer Protection Act 1986
  - Right to Safety
  - Right to be Informed
  - Right to Choose
  - Right to be Heard
  - Right to Seek Redressal
  - Right to Consumer Education
- Responsibilities of Consumers shall include the following
  - Be quality conscious
  - Beware of misleading advertisements
  - Responsibility to inspect a variety of goods before making selection

- Collect proof of transaction
- Consumers must be aware of their rights
- Complaint for genuine grievances
- Proper use of products/services

- Ways and Means of Consumer Protections
  - Lok Adalat
  - Public Interest Litigation
  - Redressal Forums and Consumer Protection Councils
  - Awareness Programme
  - Consumer Organisations
  - Consumer Welfare Fund
  - Legislative Measures

- **Consumer Protection Act 1986 :** The main objective of the Consumer Protection Act 1986 is to provide better and all-round protection to consumers and effective safeguards against different types of exploitation such as defective goods, deficient services and unfair trade practices. It provides for establishment of consumer protection councils at the central, state and district levels to promote and protect the rights of consumers and a three tier quasi-judicial machinery to deal with consumer grievances and disputes.

- **Machinery for Settlement of Grievances :** The judicial machinery set up under the Consumer Protection Act, 1986 consists of consumer courts (forums) at the district, state and national levels. These are known as District forum, State Consumer Disputes Redressal Commission (State Commission) and National Consumer Disputes Redressal Commission (National Commission) separately.

KEY TERMS

Consumer	Consumer Organisation	Consumer Protection
Consumer Protection Council	CPA 1986	District Forum
Goods	Grievances	Lok Adalats
National Commission	PIL	Redressal Forum
Responsibilities of Consumers	Rights of Consumers	Services
State Commission		

TERMINAL EXERCISE

Very Short Answer Type Questions

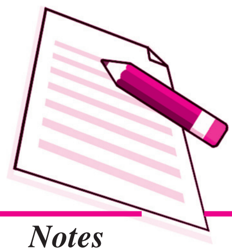
1. Give the meaning of Consumer.
2. What is meant by consumer protection?
3. What do you mean by consumer awareness?
4. State any two examples of consumer exploitation.
5. Name the three tier judicial machinery under the Consumer Protection Act 1986.
6. Mention any four standard quality certification marks.

Short Answer Type Questions

7. State the various publicity measures initiated by the government to increase the level of awareness of consumers.
8. Explain the meaning of Goods and Services as per CPA 1986.
9. Write any two points that describe the role of NGOs in protecting the consumer.
10. Explain the composition and jurisdiction of state commission.
11. State the purpose of creating Consumer Welfare Fund.
12. Who can file a complaint for redressal of grievances under the Consumer Protection Act 1986?

Long Answer Type Questions

13. Explain the needs for consumer protection.
14. Describe the right of a consumer as per CPA 1986.
15. Explain the role of consumer organisation for consumer protection.
16. Briefly explain the importance of consumer protection to customer.
17. A shopkeeper sold you some spices claiming that it was pure. Later a laboratory test showed that these were adulterated. As a consumer what action would you like to take against this wrongful act of the shopkeeper?
18. One of your friends has recently bought a washing machine from the market by paying Rs.15,000. After using a day or two he found some mechanical problem in the machine. Immediately he informed the dealer but the dealer did not respond to repair or replace the machine. Now he wants to lodge a complaint in a consumer court. Which consumer court should he go and why? Also state any three possible reliefs the court may order in favour of your friend.



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19. Your friend bought a ceiling-fan from an electronic equipments shop. When she fitted the fan at home, she discovered that it was not functioning. The shopkeeper now refuses to exchange the fan or return the money. Where and how can your friend file a complaint to get redressal of her grievance?

ANSWERS TO INTEXT QUESTIONS

24 .1 2. (a) √ (b) X (c) √ (d) √

24 .2 1. (a) the relevant laws which are aimed at preventing unfair trade practices
(b) the ways and means which dishonest traders and producers may adopt to deceive the consumers,
(c) the procedure to be followed by consumers while making complaints.

2. (a) Right to safety (b) Right to be informed
(c) Right to be heard (d) Right to choose
(e) Right to consumer education

3. (i)

24 .3 2. (a) Lok Adalat (b) Awareness Programme
(c) Redressal Forums (d) Public Interest Litigation
(e) Public Interest Litigation

24 .4 2. (a) Yes (b) Yes (c) No (d) Yes (e) No

24 .5 1. (a) High Court Judge (b) District Judge
(c) Supreme Court Judge

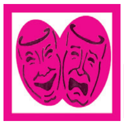
2. (a) National Commission (b) National Commission
(c) State Commission (d) District Forum
(e) State Commission

DO AND LEARN

Find out from persons in your family and of your locality about the products that they have bought and are using, like groceries, clothing and durable goods like Radio, T.V., Cycle, Scooter etc.

Make a list of about 10 such products and also note down against each item, after asking these people, the problems that they face in using these products (safety hazard, poor quality, not durable, etc.)

Identify which of their rights as consumers are violated as a result of each of these problems. Also, mention how these problems could have been avoided through responsible consumer behaviour by these people?



ROLE PLAY

Two friends, Gopal and Jaggu had gone to the market to buy the medicine for the ailing mother of Gopal. Jaggu is student of Business Studies, while Gopal is working as a computer operator. Read the conversation between them as given below:

Gopal : Jaggu, please come immediately to my house.

Jaggu : Why? What happened! What is the urgency?

Gopal : My mother is not well.

Jaggu : Don't worry, I am coming right now. In the mean time call the doctor.

Gopal : Yes, I will do that.

The doctor pays a visit and prescribes certain medicine.

Jaggu : What did the doctor say?

Gopal : He says it is typhoid and gave the prescription for medicines.

Jaggu : Okay, let us go and get the medicine.

Gopal : (to the shopkeeper) Sir, please give me all the medicine written here.

Shopkeeper : Here is medicine, do you want the cash memo.

Gopal : No, I don't want the cash memo. I know you very well!

Jaggu : No don't do that. It is important to collect the cash memo even if you know him well.

Gopal : But why?

Jaggu explained to Gopal about the importance of Cash memo and other responsibilities of a consumer. Put yourself in place of Jaggu and your friend in place of Gopal and continue the conversation.

निष्ठा धृति : सत्यम

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