Senior Secondary Course

BUSINESS STUDIES (319)

2

Course Coordinator
Dr. Piyush Prasad

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NATIONAL INSTITUTE OF OPEN SCHOOLING
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Chairman's Message

Dear learners

As the needs of the society in general, and some groups in particular, keep on changing with time, the methods and techniques required for fulfilling those aspirations also have to be modified accordingly. Education is an instrument of change. The right type of education at right time can bring about positivity in the outlook of society, attitudinal changes to face the new/fresh challenges and the courage to face difficult situations.

This can be very effectively achieved by the curriculum renewal at regular intervals of time. A static curriculum does not serve any purpose, as it does not cater to the current needs and aspirations of the individual and society.

For this purpose only, educationists from all over the country come together at regular intervals to deliberate on the issues of changes needed and required. As an outcome of such deliberations, the National Curriculum Framework (NCF 2005) came out, which spells out in detail the type of education desirable/needed at various levels of education – primary, elementary, secondary or senior secondary.

Keeping this framework and other national and societal concerns in mind, we have currently revised the curricula of Business Studies cource at Senior Secondary Level, as per the Common Core Curriculum developed by COBSE (Council of Boards of School Education) and NCERT (National Council for Educational Research and Training) making it current and need based. Textual material production is an integral and essential part of all NIOS programmes offered through open and distance learning system. Therefore, we have taken special care to make the learning material user friendly, interesting and attractive for you.

I would like to thank all the eminent persons involved in making this material interesting and relevant to your needs. I hope you find it appealing and absorbing.

On behalf of National Institute of Open Schooling, I wish you all a bright and successful future.

(Prof. C. B. Sharma)
Chairman , NIOS

A Note From the Director

Dear Learner,

The Academic Department at the National Institute of Open Schooling tries to bring you new programmes every now and then in accordance with your needs and requirements.

The Business Studies course at Senior secondary level has now been revised as per the Common Core Curriculum developed by COBSE (Council of Boards of School Education) and NCERT (National Council for Educational Research and Training) making it current and need based.

The National Curriculum Framework developed by the National Council for Educational Research and Training was kept as a reference point. Leading experts in the subject of the country were involved and with their active involvement, study materials based on the new curriculum have been updated. Old, outdated information has been removed and new, relevant things have been added.

I am happy to place this new revised study material in Business Studies in your hands. I hope you will find the new material that is now in your hands interesting and exciting. Any suggestions for further improvement are welcome.

Let me wish you all a happy and successful future.

(Dr. Kuldeep Agarwal)
Director (Academic)
National Institute of Open Schooling

A Word With You

Dear friend,

I welcome you to this course in Business Studies for the Senior Secondary level.

We all know the importance of business in our everyday life. It not only fulfills our basic needs but also provides us comfort and makes our lives easier. It is a dynamic process that keeps on changing as per the requirements and demands of the society. The procedure and practices of business in the past are completely different from modern days. It is more exposed to risk and uncertainties than what it was in past. The use of modern technology, government's policies and the consumption pattern of the people have made the business sensitive and globally competitive. Therefore, a systematic effort is required to understand, analyse and respond to the changes that affect the functioning of business in the present day society.

Keeping in mind the above, the curriculum in the subject of Business Studies at Senior Secondary level has been designed. The whole learning material of the subject has been published in the forms two books for your convience. The first book has three modules. Learning experiences considered essential for Business Studies are described in the first two modules. The module on Business Around Us has lessons on Nature and Scope of Business; Business Support Services; Buniess Environment and Modern Modes of Business where as the module on Forms of Business Organisations incorporates lessons on Forms of Business Organisation; Company Form of Business Organisations and Public Sector Enterprises. The third module on Preparing for Employment will be helpful to you when you decide to go for empolyment. The objective is to make the learners aware about the world of employment so that after gaining knowledge they can either start their own ventures or become employed somewhere else to earn their livelihood.

The second book has five modules having 15 lessons. For your practice, a sample question paper along with the question paper design and marking scheme is provided at the end of the second book.

To make your learning process interesting and useful we have changed the layout of the pages. You will also find some attractive icons in the lesson symbolising the content of different sections. The details are given separately under the heading 'How to study your lessons'. Some new sections like, Do and Learn, Key Terms, Role Play etc.

I am sure that you will find the lessons and their approach interesting and would be able to apply your knowledge in the real life situations. So read all the lessons of this course carefully and be prepared for the examination with confidence. If you face any difficulty in your studies, please feel free to write to me. Your suggestions are valuable for us.

Good luck and happy learning.

Dr. Piyush Prasad
Academic Officer

How To Study Your Lessons

Congratulation! You have accepted the challenge to be a self-learner. It means, you have to organise your study, learn regularly, keep up your motivation and achieve your goal. Here it is solely you, who is responsible for your learning. NIOS is with you at every step. It has developed the material in Business Studies keeping only you in mind. A format supporting independent learning has been followed. You can take the best out of this material if you follow the instructions given below.

Title: The title of the lesson will give a clear indication of the contents within. Do read it.

Introduction: This will introduce you to the lesson and also link it to previous one.

Objectives: These are statements of outcomes of learning expected from you after studying the lesson. You are expected to achieve them. Do read them and check if you have achieved the same.

Content: Total content has been divided into sections and sub-sections. A section leads you from one content element to another and sub-section helps you in comprehension of the concepts in the content element. The text in bold, Italics or boxes is important and must be given attention.

Intext Questions: Objective types, self-check questions are asked after every section, the answers to which are given at the end of the lesson. These will help you to check your progress. Do solve them. Successful completion will allow you to decide whether to proceed further or go back and learn the unit again.

Notes: Each page carries empty space on the outer margins for you to write important points or make notes.

What You Have Learnt : It is the summary of the main points of the lesson. It will help in recapitulation and revision. You are welcome to add your own points to it also.

Terminal Questions : These are very short, short and long answer type questions that provide you an opportunity to practice for better understanding of the whole topic.

Answers to Intext Questions: These will help you to know, how correctly you have answered the Intext questions.

Key Terms: The important terms used in the lesson are highlighted in this section. Do remember these terms.

Do and Learn: In this section certain activities have been suggestead for better understanding of the concept.

Role Play: To make your learning interesting an imaginary situation is given based on any concept covered in the lesson. You are required to enact the imaginary situation through realistic behaviour. You are free to choose any other concept/topic of your choice to play the role.

Mukta Vidya Vani

Mukta Vidya Vani is a pioneering initiative of the National Institute of Open Schooling (NIOS) for using Streaming Audio for educational purposes. This application of ICT will enhance accessibility as well as quality of programme delivery of NIOS Programmes. This is a rare accomplishment of NIOS as the first Open and Distance Learning Institute to start a two way interaction with its learners, using streaming audio and the internet.

Keeping in mind the fact that the transmission is done through the web, the NIOS website (www.nios.ac.in) has a link that will take any user to the Mukta Vidya Vani. Mukta Vidya Vani thus enables a two way communication with any audience that has access to an internet connection, from the studio at its Headquarters in NOIDA, where NIOS has set up a state-of-art studio, which will be used for this purpose as well as for recording educational audio programmes meant for NIOS learners, though others can also take advantage of this facility.

Mukta Vidya Vani is a modern interactive, participatory and cost effective programme, involving an academic perspective along with the technical responsibilities of production of audio and video programmes, which are one of the most important components of the multi channel package offered by the NIOS. These programmes will attempt to present the topic/ theme in a simple, interesting and engaging manner, so that the learners get a clear understanding and insight into the subject matter.

NIOS has launched a scheme to motivate the learners to participate in the Mukta Vidya Vani by sending their Audio CD's to the respective regional centre on various subjects such as-

1. Poetry / Shloka recitation
2. Story telling
3. Radio Drama
4. Music
5. Talks on various topic related to the NIOS curriculum including Painting, Vocational Subjects etc.
6. Quiz
7. Mathematics puzzles etc.

The selected CD can be webcast on Mukta Vidya Vani and the winner participant be rewarded suitably.

Learners may visit the NIOS website and participate in live programmes from 2pm to 5pm on all week days and from 10.30am to 12.30pm on Saturdays, Sundays and all Public Holidays. The Subject Experts in the Studio will respond to their telephonic queries during this time. A weekly schedule of the programmes for webcast is available on the NIOS website. The Studio telephone number are 0120-4626949 and Toll Free No. 1800-180-2543.

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6. Company Form of Business Organisation
7. Public Sector Enterprises

Module-III : Preparing for Employment

8. Self Employment
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Module-IV : Business Management : Nature and Scope

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Module - IV

BUSINESS MANAGEMENT : NATURE AND SCOPE

Marks 10

Hours 25

Success of a business depends on how efficiently it is being managed and run. In today's world, a manager plays a significant role in the survival and growth of business. He/She should be equipped with sound knowledge of management nature, principles and scope of management. This module aims at equipping the learners with the fundamental knowledge about management of a business.

Awards Won by NIOS

Several projects have been implemented by the NIOS to tap the potential of Information and Communication Technology (ICT) for promoting of Open and Distance Learning (ODL) system. The Ni-On project of NIOS won the National Award for e-governance and Department of Information and Technology, Govt. of India. In further recognition of its On-line initiatives and best ICT practices, the NIOS received the following awards:

NIOS WINS National Award for e-Governance 2008-09

Silver icon for Excellence in Government Process Re-engineering, Instituted by Government of India Department of Administrative Reforms and Public Grievances & Department of Information Technology.

NIOS receives NCPEDP MPHASIS Universal Design Awards 2012

National Institute of Open Schooling (NIOS) has been awarded THE NCPEDP - MPHASIS UNIVERSAL DESIGN AWARDS 2012 instituted by National Centre for Promotion of Employment for Disabled People. The award was given by **Sh. Mukul Wasnik, Hon'ble Minister for Social Justice and Empowerment, Govt. of India** on 14th August, 2012. NIOS has been selected for its remarkable work done for the learners with disabilities through ICT by making its web portal <u>www.nios.ac.in</u> completely accessible for such learners.

The Manthan Award South Asia & Asia Pacific 2012

The Manthan Award South Asia & Asia Pacific 2012 to recognize the best ICT practices in e-Content and Creativity instituted by Digital Empowerment Foundation in partnership with World Summit Award, Department of Information Technology, Govt. of India, and various other stakeholders like civil society members, media and other similar organisations engaged in promoting digital content inclusiveness in the whole of South Asian & Asia Pacific nation states for development. The award was conferred during **9th Manthan Award Gala South Asia & Asia Pacific 2012 at India Habitat Centre on 1st Dec. 2012.**

10

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.

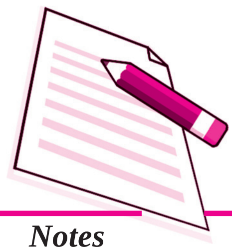
(b) Stability and Growth : Management strives to utilise the available resources of the organisation effectively and efficiently. It controls the activities and operations, integrates the functions, motivates the employees, maintains the health of the organisation in the ever changing environment. It 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.



Notes

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.

(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.

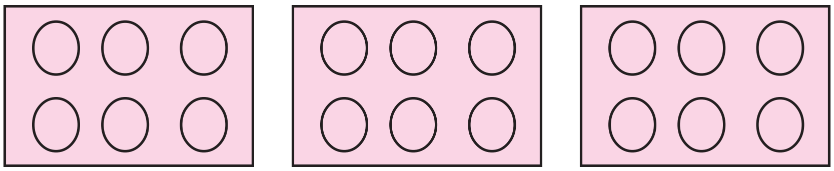
   (b) It is creative in nature

   (c) It should have universal application.

(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

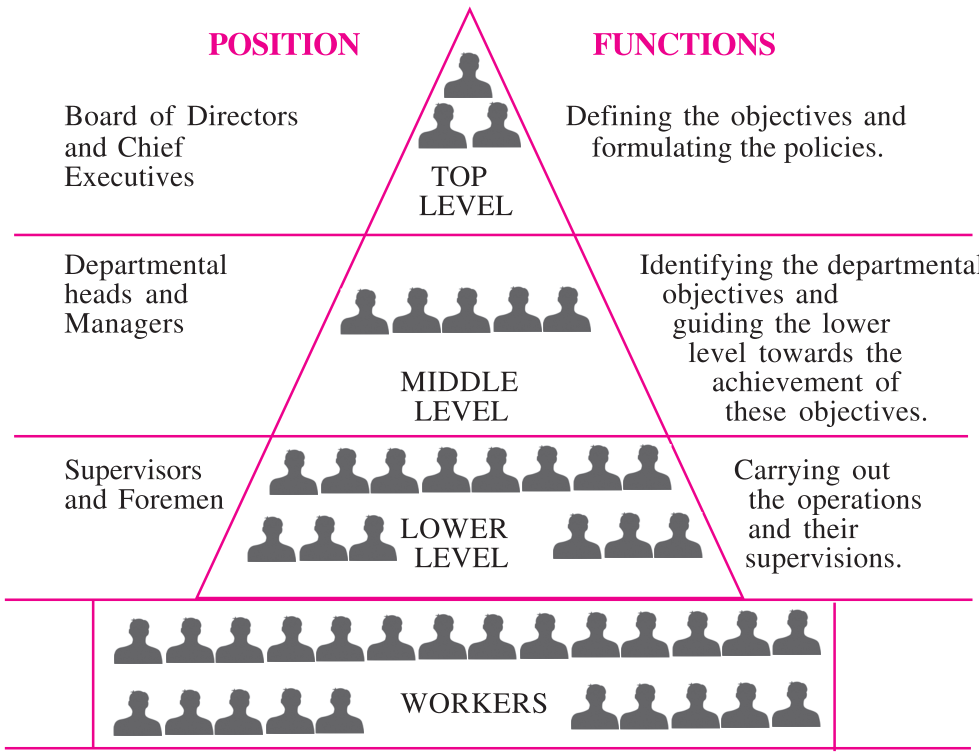
10.5 LEVELS OF MANAGEMENT

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.

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.

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.

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 :

Notes

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.

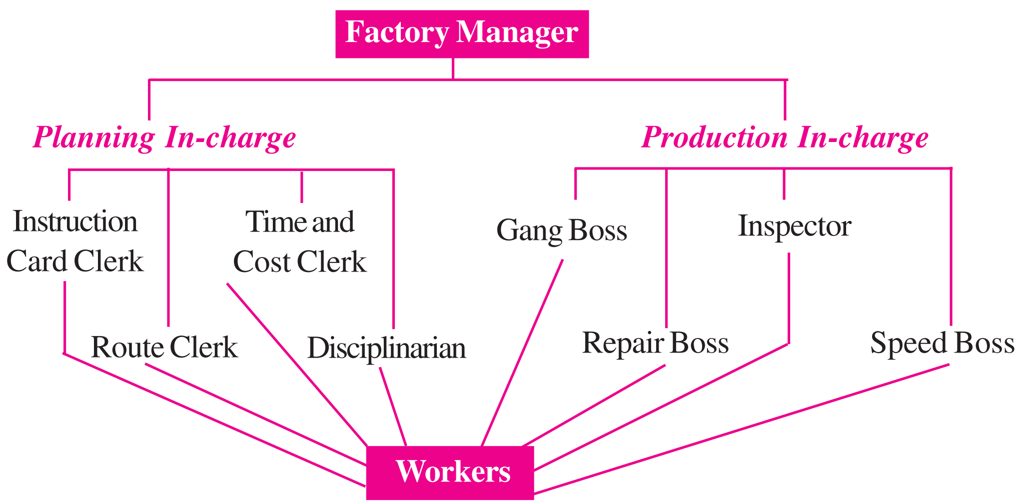
b. **Motion Study :** Under motion study, the movement of men, machines and materials are observed and analysed. Motion study eliminates wasteful motions and help to find the best method of doing a particular job.

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.

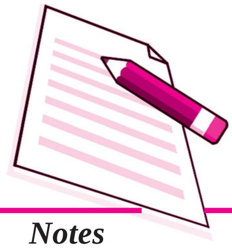


Foreman under planning Department are :

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.



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

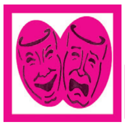
10.4 2. (a) Unity of command (b) Esprit - de-corps (c) Discipline
(d) Equity (e) Scalar Chain

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.)

Module - V

FUNCTIONS OF MANAGEMENT

Marks 20 **Hours 50**

Management plays a very significant role in the success of an enterprise. The managers have to plan, organise, direct, control and co-ordinate various activities. This module aims at preparing the learners with fundamental of management and different functions of management.

Awards Won by NIOS

Web Ratna Awards 2012 Platinum Icon under Outstanding Web Content for Acknowledging exemplary initiatives/practices in the realm of e-Governance for dissemination of information & services instituted by Department of Information Technology, Ministry of Communications & IT (MC&IT) and National Informatic Centre (NIC), Government of India. The award has been conferred by Hon'ble Minister of Communications and Information Technology Shri Kapil Sibal on 10th December 2012 at Dr. D.S Kothari Auditorium, DRDO Bhawan, Dalhousie Road, New Delhi.

TOI Social Impact Award 2012

NIOS has been selected as winner of the Social Impact Award 2012 instituted by Times of India in partnership with J P Morgan The Award is given in the recognition of magnificent work done by an individual or groups or institutions making an impact in the society in various segment including Education. NIOS feels honoured to accept the award.

The award was conferred on 28th January 2013 at a function in presence of President of India and high level dignitaries.

National Awards for the Empowerment of Persons with Disabilities, 2012

The NIOS received the National Award for the Empowerment of persons with disabilities, 2012 Instituted by Ministry Social Justice and Empowerment, Govt. of India. The NIOS got this award under the category of best accessible Website for making its website www.nios.ac.in completely accessible for person with disabilities. The website is bilingual in Hindi and English. It also has provisions of Screen Reader, increasing text size, colour contrast scheme etc. for disabled learners. This award was conferred by the Hon'ble President of India at Vigyan Bhawan, New Delhi on 6th February, 2013. Dr. S.S. Jena Chairman, NIOS received the award.

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.

Notes

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.

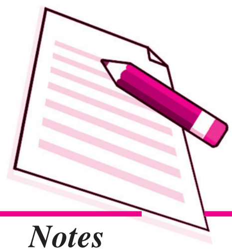
(b) Planning guides the decision making by the managers. Planning of goals to be achieved and the course of action to be followed to achieve the goal act as a guide in their own decision making and action plans.

(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.



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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.

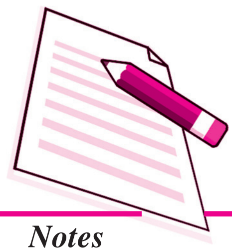
   (d) Set assumption that the technology is going to change; and that enough money is available for payment of salaries to the new managers.

   (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.



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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.

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.

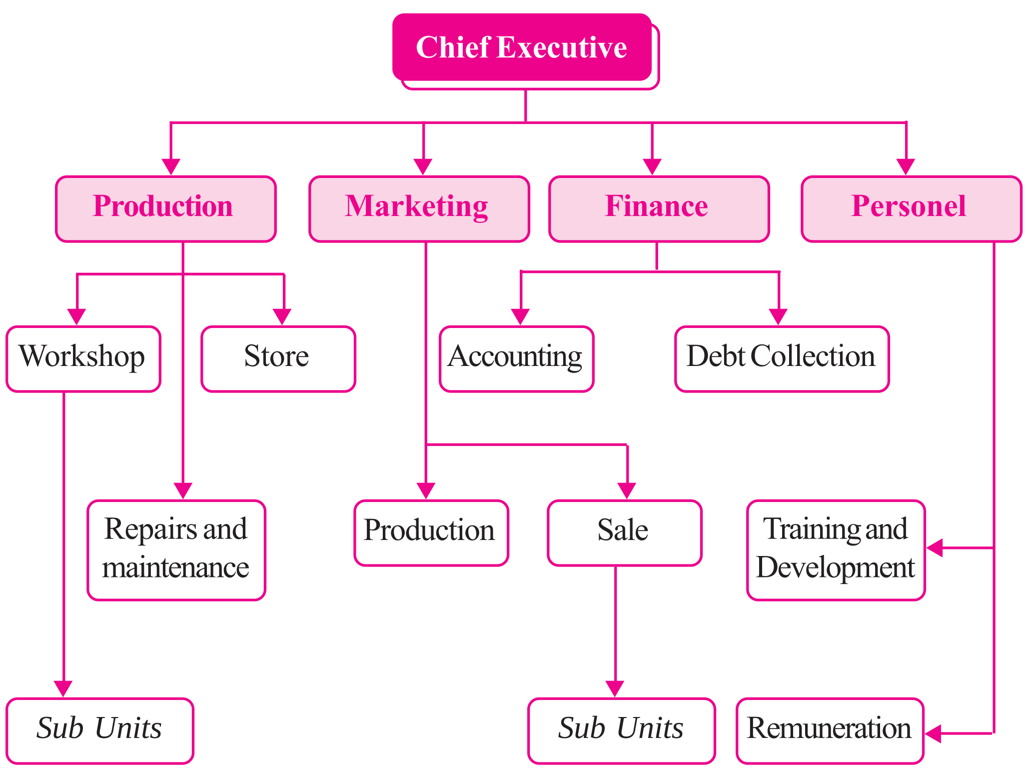
5. **Establishing relationship :** This is a very important job of management as everybody in the organisation should know as to whom he/she is to report, thereby establishing a structure of relationships. By doing so, relationships become clear and delegation is facilitated.

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.

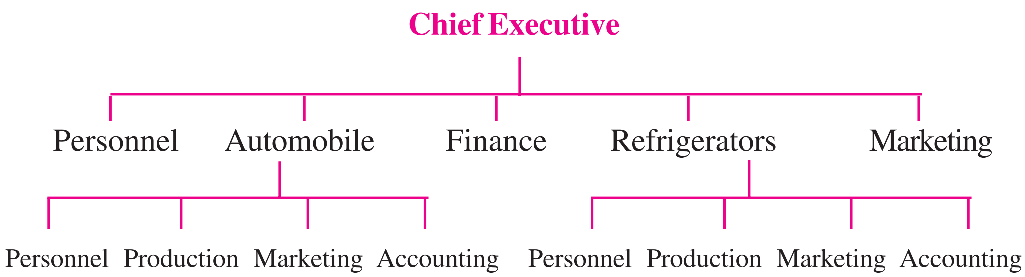
Functional Structure



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.

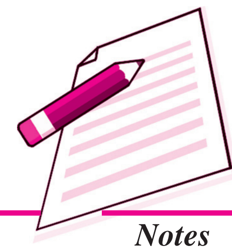
Divisional Structure
(Product based)



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 -

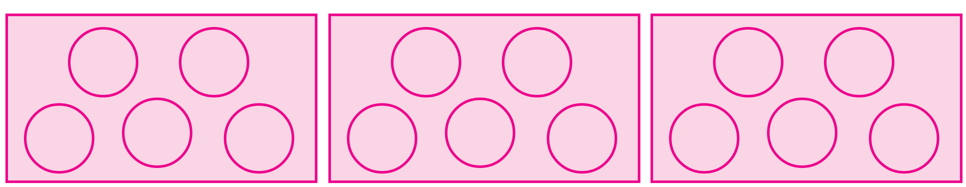
- While delegation is the process of assigning responsibility and authority and thereby creating accountability; decentralisation is the ultimate outcome of planned delegation.
- Delegation of authority takes place between the manager and his subordinates while decentralisation involves the entire organisation, 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.

Notes

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.

- 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.

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.

Notes

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.

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 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).

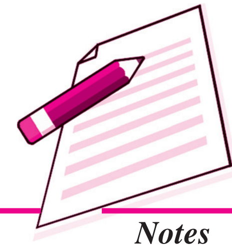
These two aspects of job analysis (job description and job specification) are useful in recruitment and selection of employees so as to find the right person for the job.

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 planning	(iv)	Identification of the job in terms of duties and 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.

Notes

(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.

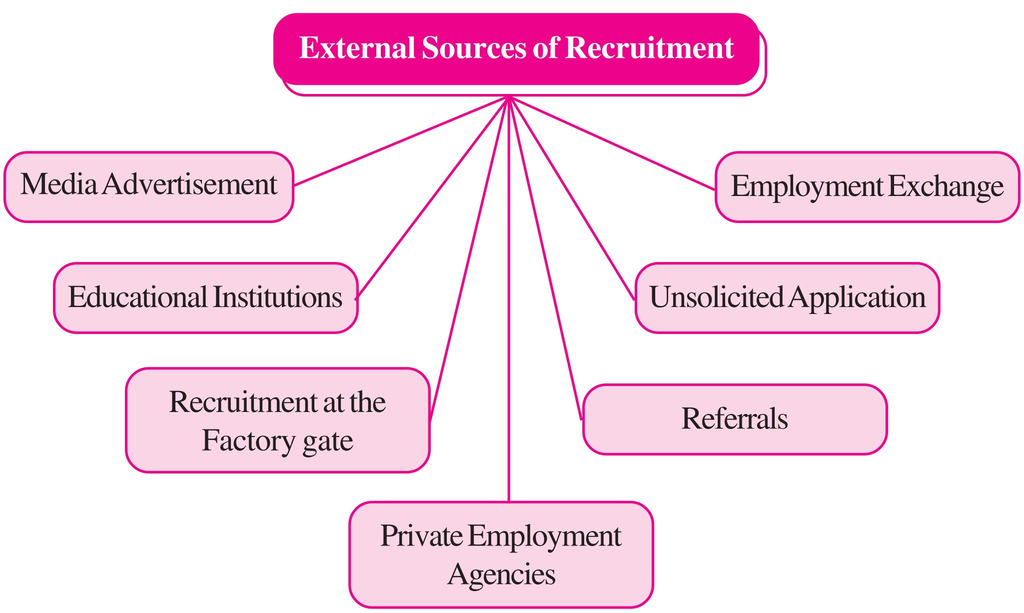
(d) Unsolicited Application : Those looking for jobs often apply on their own initiative. They assume that certain vacancies are likely to arise, and apply without references to any job advertisement. Managers keep a record of such applications and contact the suitable candidates when they need them.

(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.



Notes

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

(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.

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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.

Notes

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.

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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.

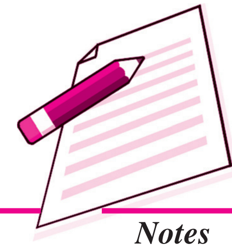
INTEXT QUESTIONS 12.4

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



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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.

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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
- Development
- Induction
- Job analysis
- Job description
- Job specification
- Manpower planning
- Off-the job training
- On-the-job training
- Performance appraisal
- Placement
- Promotion
- Recruitment
- Selection
- Training
- Transfer

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)

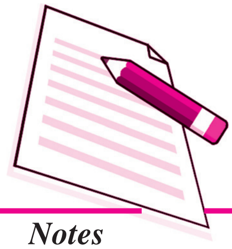
12.5 1. (a) Training is necessary for new employees as well as existing employees.

(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.



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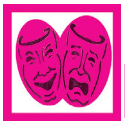
DO AND LEARN

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.)

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.

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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

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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	(i) Upward	(i) verbal - (a) oral, (b) written
(ii) Informal	(ii) Downward (iii) Horizontal (iv) Diagonal	(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.

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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.

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.

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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.

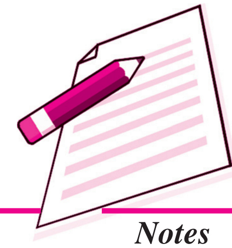
5. **Proper Feedback :** Communication is complete only when the message is understood by the receiver. The communicator can ensure the success of communication by asking questions about the message conveyed. The receiver should be encouraged to respond to the message. Thus communication becomes a two-way 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.



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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?

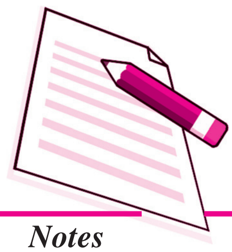
      a) Physiological needs b) Safety needs

      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



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.

- 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

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.

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 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.

Notes

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.

Notes

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.

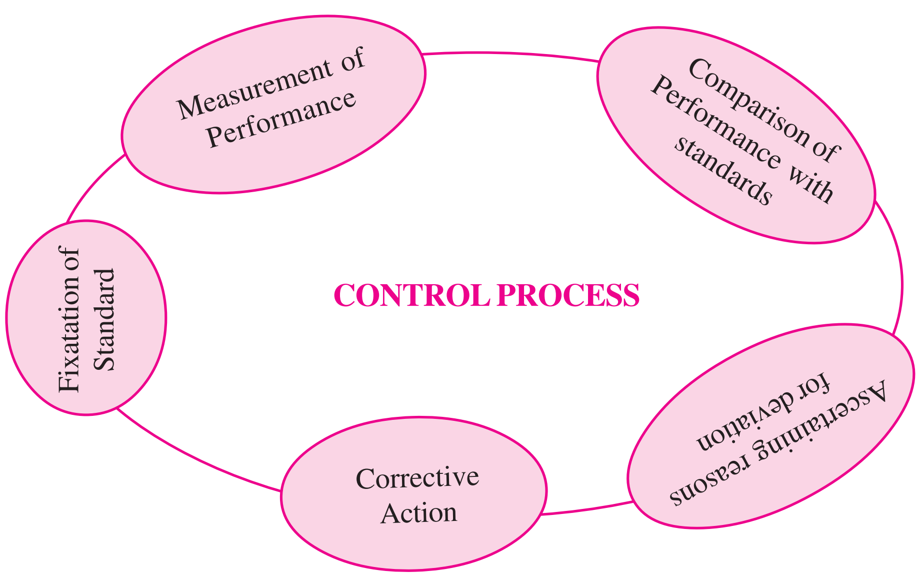
(c) Control is forward looking.

(d) Control is a continuous process.

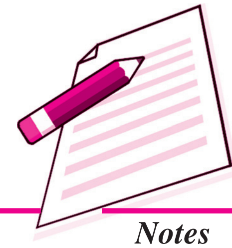
14.6 PROCESS OF CONTROL

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.



Notes

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.

Notes

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.

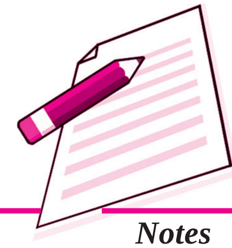
Long Answer Type Questions

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.



(c) Correct

(d) Coordination is the function of all levels of management.

(e) Correct

14.2 (a) DEVIATION (b) PERVASIVE

(c) FUTURISTIC (d) ONGOING

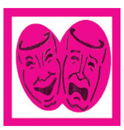
14.3 1. (a) – (iii) (b) – (i) (c) – (ii)

(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?

Notes

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.

Module - VI

BUSINESS FINANCE

Marks 20

Hours 50

Finance is an essential pre-requisite to start and run a business. So it is required to realize the need of finance, amount of financial requirement for a business, from where and how finance has to be raised by a business. This module discusses the kinds of requirements of funds by a business and various alternatives available to obtain those funds.

Success Stories

Kavya Madhavan
Enrolment No. 090008103065

Kavya Madhavan is a highly acclaimed actress in the Malayalam film world. Making her debut as a child artiste, Kavya quickly managed to find a place in the hearts of malayalees. However, all this was at the cost of dropping out of school at the Secondary level. Like many others, she too nurtured a dream of acquiring a college degree. Motivated to join the National Institute of Open Schooling (NIOS), Kavya Madhavan appeared for the Senior secondary level examination in Malayalam medium and emerged successful. But this was not achieved easily, she says.

Thanks to the Open Schooling system, Kavya Madhavan has now registered for B.Com in M.G. University, Kottayam, Kerala.

Ganesh
Enrolment No. Secondary Course: 25001292005
Senior Secondary Course: 250012103570

Ganesh has cleared the Secondary course of NIOS with first division and has now appeared in 4 subjects of Senior Secondary course. What differentiates Ganesh from other students is that he is suffering from a non-healing ulcer of bone infection. There is no treatment for his ailment; his lower part below the belt has not grown. The puss leaks from his body continuously. He cannot move, and even has no sensation in the lower part of his body. He has to be carried to be moved from one place to another.

However, support from his family members and the Chief Commissioner of Disabilities facilitated his enrolled as a student under Sarva Shiksha Abhiyan as a private candidate, thereby enabling him to clear Class 5 and Class 8. It was at this point that NIOS came to his rescue by providing the flexibility of studying at his own pace through credit accumulation. He could also study subjects of his own choice and was further allowed to appear for the examination in his house. UT Chandigarh continued to support him by providing him with the facility of tutors, who taught him Maths and Science.

With a keen interest in religion, he has read about the various *Puranas, Ramayana* etc., from which he has derived a lot of internal strength.

Ganesh is certainly determined to study further and wishes to pursue a course in Computer Science after clearing his Senior Secondary course from the NIOS.

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.

Notes

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.

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.

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 :

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.

Notes

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 automobiles 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.

(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.

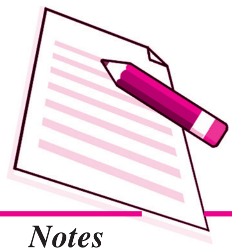
   b) Small Enterprise : A unit with an investment above Rs. 10 lakh and up to Rs. 2 crore.

   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.



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.

Notes

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.

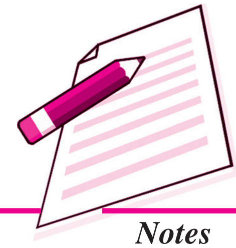
Limitations of Equity Shares

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.

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.

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

$$\text{Return on Equity Share Capital} = \frac{75,00,000}{2,50,00,000}\times 100 = 30\%$$

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

$$\text{Return on Equity Share Capital} = \frac{60,00,000}{1,00,00,000}\times 100 = 60\%$$

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.

Notes

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.

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.

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.

Notes

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.

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

- 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.

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

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(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.

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

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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.

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.

(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.

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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.

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.

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

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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.

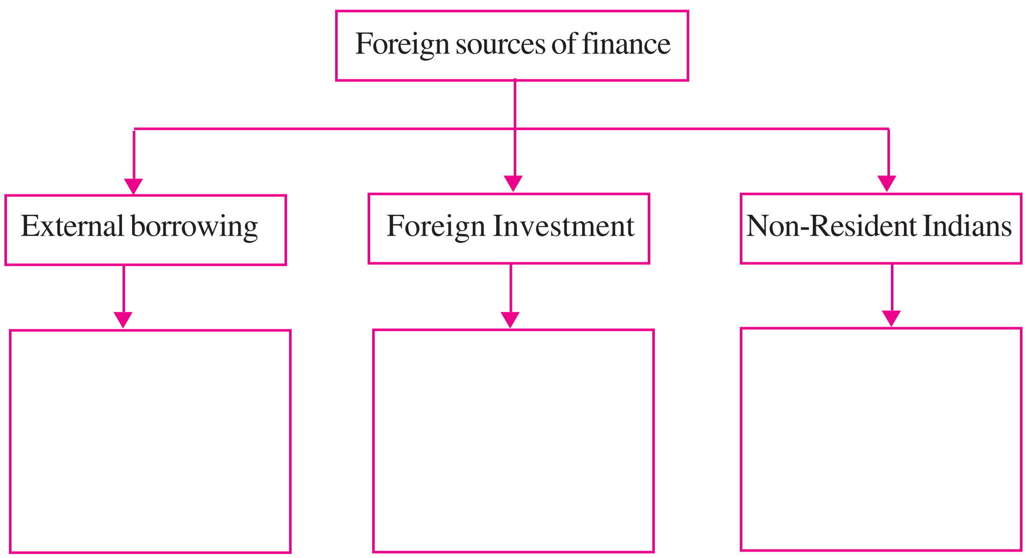
It is an internal source, which does not involve any cost of floatation and the uncertainties of external financing. In fact, it is regarded as the most dependable source of long-term finance. It also strengthens the firm's equity base, which enables to borrow at better terms and conditions. The main 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.

- 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

Notes

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.

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;

- 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

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.

Notes

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.

Notes

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.

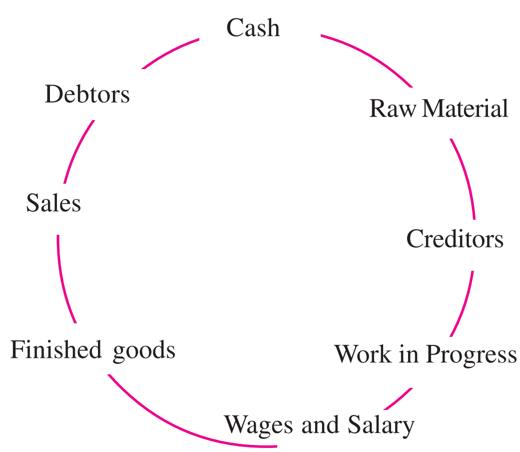
Notes

(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.

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.



Working Capital Cycle

17.3.4 Factors Determining 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 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.

Notes

(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

Notes

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.

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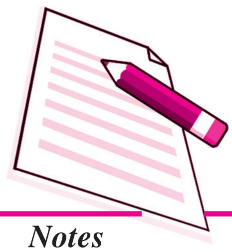

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3. **Access to capital market :** A company which, by virtue of its record of profitability and timely repayment of debt, has better access to capital market i.e., it can successfully raise funds by issuing shares and debentures through the capital 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,

Notes

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.

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.

(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.

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)

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.

Notes

(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.

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.

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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.

Notes

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.

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 7^{th} 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.

Notes

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

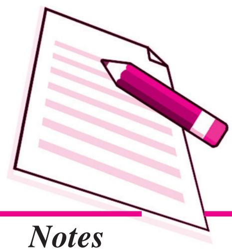
1. Enumerate the main characteristics of a stock exchange.

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.



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(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.

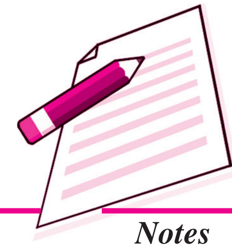
18.9 STOCK EXCHANGES IN INDIA

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



Notes

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.

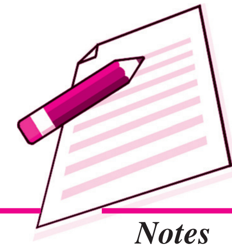
     a) Savings b) Current

     c) Demat d) Both (a) and (b)

Notes

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.



Notes

- 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?

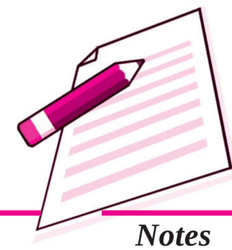
Long Answer Type Questions

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.



Notes

(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.

Module - VII

MARKETING MANAGEMENT

Marks 20 **Hours 50**

Business exists to satisfy the wants of consumers. The products should be made available to consumers in the form they like, at the place of their convenience, at a price they are willing to give and it should be attractive to the consumers. Only then can a business survive and be successful. This module has been designed to develop amongst the learners an insight into marketing aspect of business.

Success Stories

Jaspal Singh
Enrolment No.: Secondary - 27020212195
Senior Secondary – 92279300066

Forced to discontinue his tenth class in 1993 in order to earn a livelihood to support his family, when his parents met with an accident, Jaspal Singh resumed his studies in 2003 by enrolling for the Secondary level course in NIOS. The flexibility of the NIOS system enabled him to pursue his studies along with his vocation. He acquired skills in fashion designing while working as a freelancer in garment export houses.

Having completed his Senior Secondary course from the NIOS and moved by the desire to continue studies, Jaspal Singh has managed to obtain admission to a three year course in Fashion Management at the University of Thames Valley, London.

Ms. Sudha
Enrolment No. : 27029182593

Ms. Sudha was a only housewife until such time that her husband passed away and she was offered the job of a constable in the Delhi Police. She then took up the job to support the family consisting of her two children.

Sudha who had not completed her schooling was motivated by her children to join the NIOS. She then passed the Secondary examination from NIOS in April 2009. A resident of Sant Nagar, Burari, Delhi and posted at the Rohini Court, Delhi, Sudha today feels more confident and empowered by the qualification acquired by her through the NIOS.

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.

(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.

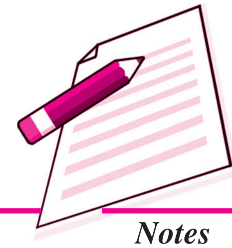
A Few Relevant Terms on Marketing

- **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.



Notes

- **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

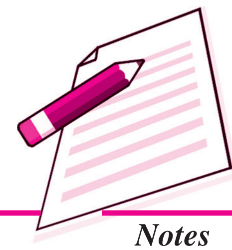
After knowing the points of importance of marketing let us discuss on the basic objectives of marketing.

(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.



Notes

(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

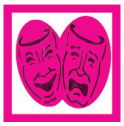
1. (a) Marketing provides better products and services to the customers.
   (b) Marketing helps in making products available irrespective of time and place.
2. (a) iv (b) v (c) ii (d) iii (e) i

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.

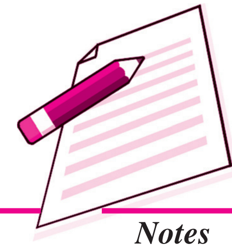
Surinder : No, you are wrong. Reason of failure of your products lies elsewhere. You must have given more emphasis on selling rather than marketing.

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.



Notes

20

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'.

Notes

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.

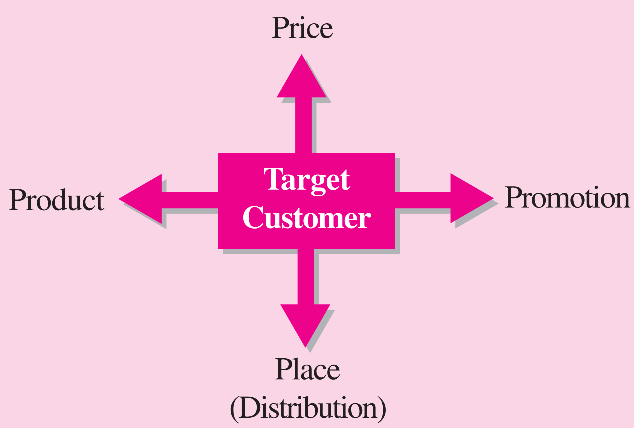
- **Product :** Product refers to the goods and services offered by the organisation. A pair of shoes, a plate of dahi-vada, a lipstick, all are products. All these are purchased because they satisfy one or more of our needs. We are paying not for the tangible product but for the benefit it will provide. 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 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***

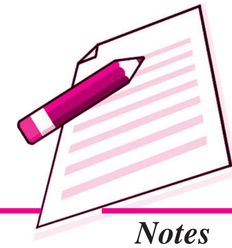
Product Classification

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 :

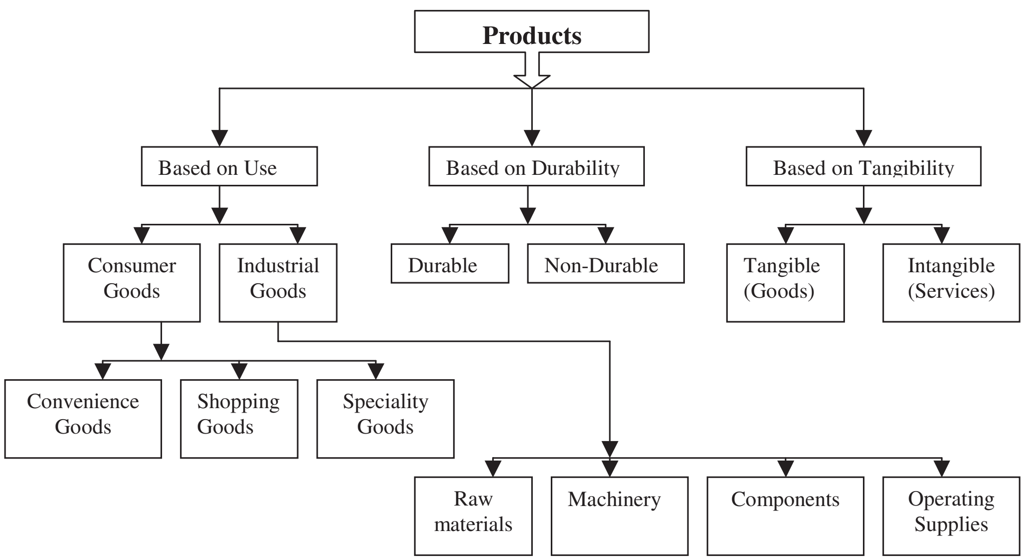
(a) Durable Goods : Durable goods are products which are used for a long period i.e., for months or years together. Examples of such goods are refrigerator, car, washing machine etc. Such goods generally require more of personal selling efforts and have high profit margins. In case of these goods, seller's 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

Notes

(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 $\boxed{}$ 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 $\boxed{}$ Non-Durable $\boxed{}$

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.

Notes

(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.

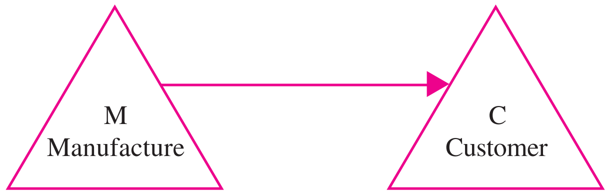
(e) It assists the provision of after sales services, if necessary.

(f) It assumes all risks connected with the carrying out the distribution function.

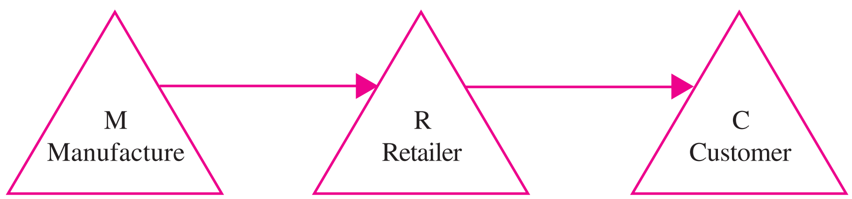
Types of Channels of Distribution

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:

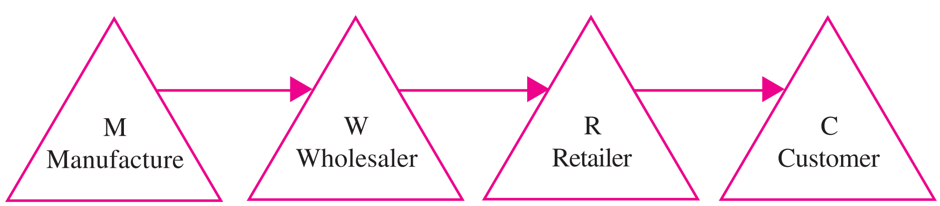
(a) **Zero Stage Channel of Distribution :** Zero stage distribution channel exists where there is direct sale of goods by the producer to the consumer. This direct contact with the consumer can be made through door-to-door salesmen, own retail outlets or even through direct mail. Also in case of perishable 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.



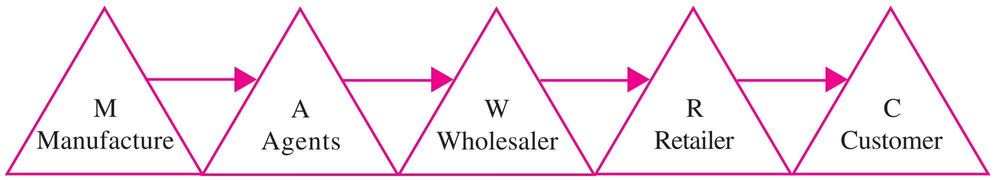
(b) **One Stage Channel of Distribution :** In this case, there is one middleman i.e., the retailer. The manufacturers sell their goods to retailers who in turn sell it to the consumers. This type of distribution channel is preferred by manufacturers of consumer durables like refrigerator, air conditioner, 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.

(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.

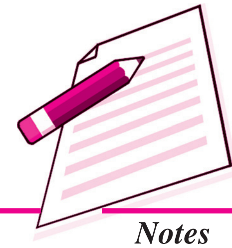
(b) **Industrial goods** are meant for consumption or use as inputs in production of other products or provision of some service.

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



Notes

- 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 $\rightarrow$ Consumers
  (b) One stage channel : Manufacturer $\rightarrow$ Retailer $\rightarrow$ Consumers
  (c) Two stage channel : Manufacturer $\rightarrow$ Wholesaler $\rightarrow$ Retailer $\rightarrow$ Consumers
  (d) Three stage channel :
  Manufacturer $\rightarrow$ Agent $\rightarrow$ Wholesaler $\rightarrow$ Retailer $\rightarrow$ 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.

Notes

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

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*

Notes

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.

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.

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.

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.

Notes

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.

(a) Benefits to Manufacturers
- (i)
- (ii)

(b) Benefits to Consumers
- (i)
- (ii)

(c) Benefits to Society
- (i)
- (ii)

2. State any four limitations of advertising.

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 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.

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.

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.

Notes

(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

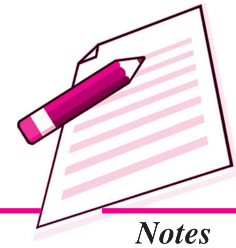
21.2

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.		

Notes

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.

Module - VIII

TRADE & CONSUMER PROTECTION

Marks 10 **Hours 25**

Trade and consumer protection are related in the sense that the consumers buy goods and services from the traders offering the same. This module has been developed in such a manner that the learners are able to understand the different ways in which internal or domestic trade is organised and the procedure to external trade as well as the various aspects of consumer protection.

Lesson 22. Internal Trade

Lesson 23. External Trade

Lesson 24. Consumer Protection

Mukta Vidya Vani

Mukta Vidya Vani is a pioneering initiative of the National Institute of Open Schooling (NIOS) for using Streaming Audio for educational purposes. This application of ICT will enhance accessibility as well as quality of programme delivery of NIOS Programmes. This is a rare accomplishment of NIOS as the first Open and Distance Learning Institute to start a two way interaction with its learners, using streaming audio and the internet.

Keeping in mind the fact that the transmission is done through the web, the NIOS website (www.nios.ac.in) has a link that will take any user to the Mukta Vidya Vani. Mukta Vidya Vani thus enables a two way communication with any audience that has access to an internet connection, from the studio at its Headquarters in NOIDA, where NIOS has set up a state-of-art studio, which will be used for this purpose as well as for recording educational audio programmes meant for NIOS learners, though others can also take advantage of this facility.

Mukta Vidya Vani is a modern interactive, participatory and cost effective programme, involving an academic perspective along with the technical responsibilities of production of audio and video programmes, which are one of the most important components of the multi channel package offered by the NIOS. These programmes will attempt to present the topic/ theme in a simple, interesting and engaging manner, so that the learners get a clear understanding and insight into the subject matter.

NIOS has launched a scheme to motivate the learners to participate in the Mukta Vidya Vani by sending their Audio CD's to the respective regional centre on various subjects such as-

1. Poetry / Shloka recitation
2. Story telling
3. Radio Drama
4. Music
5. Talks on various topic related to the NIOS curriculum including Painting, Vocational Subjects etc.
6. Quiz
7. Mathematics puzzles etc.

The selected CD can be webcast on Mukta Vidya Vani and the winner participant be rewarded suitably.

Learners may visit the NIOS website and participate in live programmes from 2pm to 5pm on all week days and from 10.30am to 12.30pm on Saturdays, Sundays and all Public Holidays. The Subject Experts in the Studio will respond to their telephonic queries during this time. A weekly schedule of the programmes for webcast is available on the NIOS website. The Studio telephone number are 0120-4626949 and Toll Free No. 1800-180-2543.

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.

Notes

(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.

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

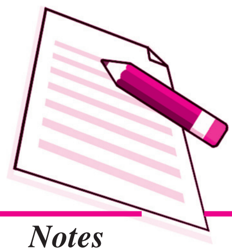
1. List five items of daily necessity that are available in super markets.
2. Make necessary corrections and rewrite the following sentences:

   (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.



Notes

(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 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

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 :

Notes

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.

Notes

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.

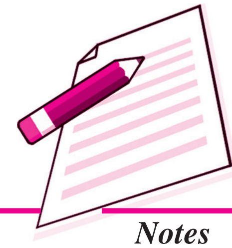
22.5 1. (a) Food items (b) Vegetables (c) Fruits
(d) Groceries (e) Utensils

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

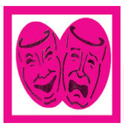
2. (a) Franchise is a form of retailing where two parties enter into an agreement in which one party authorises the other to sell or produce and sell specified goods and services.
(b) The party that develops a product/service or is the owner of an expertise who authorises other to sell or produce and 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.

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.

Notes

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.

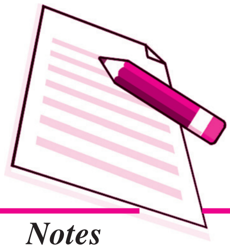
(h) **Proper Utilisation of Natural Resources :** External trade is a means through which the natural resources of various countries can be properly utilised. For example, a country may be rich in minerals but due to lack of technological advancement it is not able to extract those minerals from the 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.



Notes

(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.

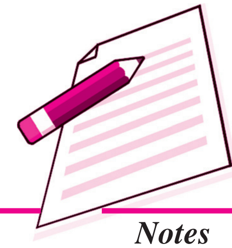
(e) **Lack of Personal Touch :** In external trade, the transactions are made with unknown persons through correspondence and other means of communication. There is no direct contact between the buyer and seller. So the risk of dispute and bad debts are always there.

(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.



Notes

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.

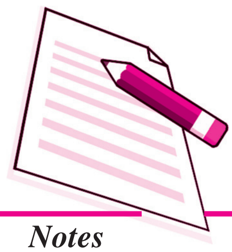
4. **Clearing Agents :** Clearing agents act on behalf of the importer and complete all formalities required for clearing the goods from the port of destination. He takes delivery of the goods from the customs authority and sends the goods by rail/road to the place of importer.

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.



Notes

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.

Notes

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.

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.

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	*Export trade*	*Entrepot trade*
- A firm purchases goods and services from another country	- A firm sells goods and services to another country	- 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

- 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
  - Bill of Lading
  - Documentary Bill
  - Shipping order
  - Mates Receipt
  - Consular Invoice
  - Airway bill
  - Bill of Entry
  - Letter of Credit
  - Advice Letter
  - Insurance Policy
  - Shipping bill
  - Dock challan etc.
  - Certificate of origin
  - Export Invoice/Foreign Invoice

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?

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.

Notes

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.

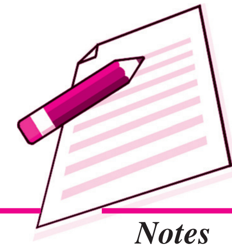
OBJECTIVES

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



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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.

(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.

Notes

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.

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.

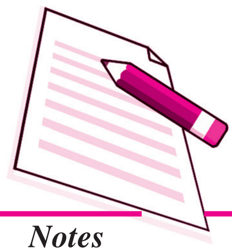
   a) Tata Consultancy Service   b) Reliance Ltd.

   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.



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(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

(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.

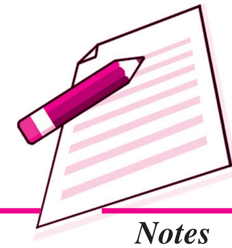
   (d) The seller compels the consumer to purchase the available product.

   (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



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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.

Notes

(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?

(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.

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.

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

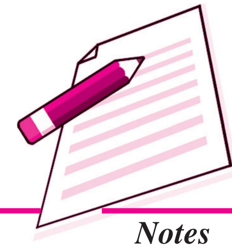
1. Give any two reliefs available to a consumer under the CPA 1986.

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?



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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.

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		

Notes

TERMINAL EXERCISE

Very Short Answer Type Questions

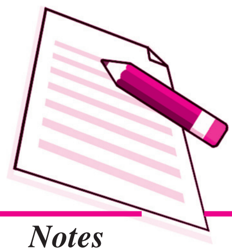
1. Give the meaning of Consumer.
2. What is meant by consumer protection?
3. What do you mean by consumer awareness?
4. State any two examples of consumer exploitation.
5. Name the three tier judicial machinery under the Consumer Protection Act 1986.
6. Mention any four standard quality certification 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.

SENIOR SECONDARY COURSE
BUSINESS STUDIES
(319)
SAMPLE QUESTIONS PAPER

Time : 3 Hours ***Max. Marks: 100***

Instructions:

i. Answer all the questions on separate sheet of paper.

ii. Marks are indicated against each question.

iii. Check your answer from the points given in the lessons.

iv. Do not send your answer sheet to National Institute of Open Schooling.

1. Carrying out the operations and their supervision is the responsibility of which of the following: (1)

(a) Top level management (b) Middle Level Management

(c) Lower Level Management (d) Worker

2. Management is a discipline because it. (1)

(a) It consists of team of manages.

(b) Its members observe code of conduct.

(c) It has developed and grown through practice and research.

(d) It includes series of interrelated activities.

3. Which of the following is an internal planning premise (1)

(a) Market demand. (b) Methods of production.

(c) Government policies. (d) Nature of competition.

4. Which of the following is not an element of delegation (1)

(a) Establishing objectives. (b) Creating Accountability.

(c) Assignment of Responsibility. (d) Granting Authority.

5. The management function which help in getting the right persons for the organization is called. (1)

(a) Planning. (b) Organizing.

(c) Directing. (d) Staffing.

6. The type of finance required to purchase raw material is called. (1)

(a) Short-Term Finance (b) Medium – Term Finance.

(c) Long-Term Finance (d) Working Capital.

7. Which of the following is not a characteristic of financial planning : (1)

(a) Simplicity (b) Liquidity.

(c) Flexibility (d) Adequate availably of funds.

8. Which of the following is not a tangible good. (1)

(a) Insurance Services (b) Car

(c) Washing machine (d) Raw material

9. Which of the following channels of distribution will be suitable for perishable products: (1)

(a) Zero level (b) One level

(c) Two level (d) Three level

10. A document on the basis of which the custom authority calculates the duty to be paid by the exporter is called. (1)

(a) Makes receipt (b) Shipping Bill

(c) Shipping order (d) Insurance policy

11. State the following principles of general management : (3)

(a) Remuneration and (b) Unity of Command

12. Explain Trade Credit as a sourse of short term finance. (3)

13. Distinguish between advertising and publicity on the basis of (3)

(a) Identified sponsor and (b) Control.

14. How does 'demand' affect the price of a product? (3)

15. Who establishes the 'District Forum' according to the provisions of Consumer Protections Act 1986? State its composition. (3)

16. With increasing size and scale of operations the significance of coordination becomes more important. Do you agree? Give any three reasons in support of your answer. (3)

17. With the help of a diagram explain the divisional structure of management. (4)

18. The dividend to be paid to the equity shareholders is the real issue involved in dividend decision and is guided by a number of factors. Briefly explain any two such factors. (4)

19. There are two alternative methods by which payment can be received by the exporter. Briefly explain these methods. (4)

20. Wholesales are unnecessary link in the channel of distributions. Do you agree? Give any for reasons in support of your answer. (4)

21. State any five characteristics of management. (5)

22. Briefly explain the importance of communication in an organization. (5)

23. Describe briefly 'Call Money' and 'Commercial paper' as money market instruments. (5)

24. A business unit cannot move a single step without sufficient funds. Elaborate any five purposes for which funds are required. (5)

25. Briefly explain the objectives of 'Sales Promotion'. (5)

26. Advertising is a social waste. Comment upon the statement with six points in support of your statement.

Or

Marketing Manger of SIC Global limited wants to fix the price of a product of his company. Describe any four actors which are to be considered by him for fixing the price. (6)

27. A manufactures of detergent powder wants to introduce detergent cake in the market under a new brand name? Which sales promotion tools should be use to attract the Customers? Give reasons in support of your answer. (6)

Or

"Channel 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.

28. "Raising of long term funds through debt affect the return on shareholders funds. Explain the statement with an example. (6)

Or

"Adequate working capital is very necessary for maintenance of liquidity and running the business smoothly and efficiently. Explain briefly the various factors that affect the requirement of working Capital.

29. Can Management be treated as a profession? Give reasons in support of your answer. (6)

Or

With the help of a diagram explain functional foremanship.

30. Four persons have to be selected out of 20 applicants for the post of sales Executives. Explain the steps which are to be followed to select them. (6)

Or

"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.

SENIOR SECONDARY COURSE
BUSINESS STUDIES
(319)
MARKING SCHEME

Time : 3 Hours ***Max. Marks: 100***

Instructions

i. Answer all the questions on separate sheet of paper.

ii. Marks are indicated against each question.

iii. Check your answer from the points given in the lessons.

iv. Do not send your answer sheet to National Institute of Open Schooling.

Q. No.	*Answer/Value Points*	*Distribution of Marks*	*Total Mark*
1.	(c)	1	1
2.	(c)	1	1
3.	(b)	1	1
4.	(a)	1	1
5.	(d)	1	1
6.	(a)	1	1
7.	(d)	1	1
8.	(a)	1	1
9.	(a)	1	1
10.	(b)	1	1
11.	**(a) Remuneration :** Management should try to give fair wages to the employees so as to ensure reasonable satisfaction of workers and productivity for the organisation.	1.5	
	(b) 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.	1.5	3

12. 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 3 3
a very popular source of short term finance.

13. **(a) Sponsor :** In case of advertising the sponsor is identified where
as there is no identified sponsor in case of publicity. 1.5

(b) Control : The sponsor has full control over the contents of the
message, type, period and continuity is case of advertising where 1.5 3
is in publicity the firm does not have any control over the same.

14. If the demand of a product is more than its supply than the customers will buy the product even at a higher price fixed by the producer. But what should be the price of the product will depend on the paying capacity and the dependence of the customers on the product *e.g.*,
affects to price. 3 3

15. This is established by the state governments in each of its districts. 1

Composition : The district forums consist of a Chairman and two
other members one of whom shall be a woman. The district forums 2 3
are headed by the person of the rank of a District Judge. 1

16. **Yes.**

(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 1
organisational goals. 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 1
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 1 4
coordination more difficult as well as important.

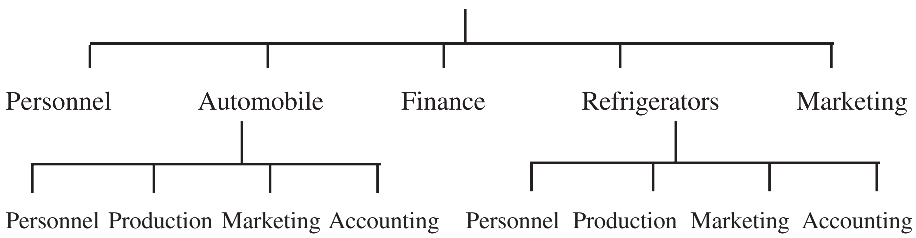
17. **Divisional Structure**

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



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 4 4
much difficulty. However, this structure is expensive and gives rise to duplication of efforts.

18. Brief explanation of any two of the following factors affecting dividend decisions : (2 marks each)

(i) Financial needs of the company (ii) Liquidity requirement (iii) Access to capital market (iv) Expectations of Shareholders (v) Tax Policy 4
(vi) Investment opportunities and growth prospectus (vii) Legal Constraints

19. Brief explanation of the following methods of securing payment 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. 2

(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. 2 4

20. Answer in favour any four reasons. (one mark each for each correct reason)

    Answer against any four reasons. (one mark each for each correct reason) 4

21. Any five of the following characterstics : (one mark each)

    (a) Management is Universal (b) Management is Goal Directed (c) Management is a Contineous Process (d) Management is an Integrating Process (e) Management is Intangible (f) Management is Multidisciplinary (g) Management is a Social Process (h) Management is Situational 5

22. Importance of Communication :

    - Communication helps employees to understand their role clearly and perform effectively. 1
    - It helps in achieving co-ordination and mutual understanding which in turn, leads to industrial harmony and increased productivity. 1
    - Communication improves managerial efficiency and ensures cooperation of the staff. 1
    - Effective communication helps in moulding attitudes and building up employees' morale. 1
    - Communication is the means through which delegation and decentralisation of authority is successfully accomplished in an organisation. 1 5

23. **(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. 2.5

(b) **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. 2.5 5

24. Any five of the following purposes : (one mark each)

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. 5

25. **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). 1

2. Persuades Customers : Sales Promotion activities aim at arousing customers' interest in the product and persuading them to buy. 1

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. 1

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. 1

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. 1 5

26. Advertising is a social waste because of the following reasons :

(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. 1

(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. 1

(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. 1

(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. 1

(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. 1

(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. 1 6

OR

Methods of Price Fixation

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. 1.5

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. 1.5

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 1.5

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. 1.5 6

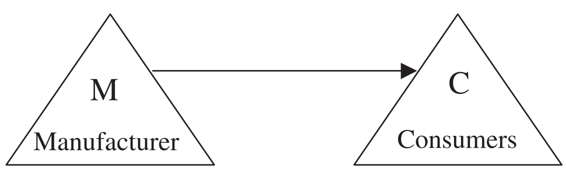
27. Brief explanation of the following tools of sales promotion for detergent powder :

1. Distribution of Free Samples
2. Bonus Offer
3. Price-off
4. Free Offer
5. Money Refund Offer
6. Discount Coupon

6

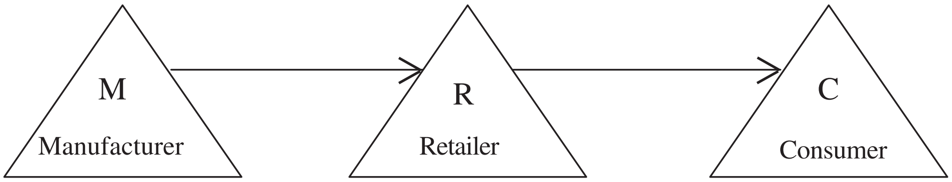
OR

a) Zero stage channel of distribution



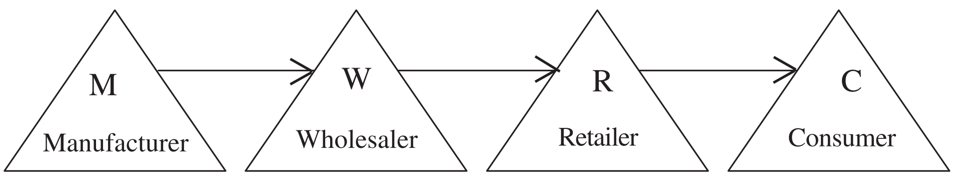
Zero stage distribution channel exists where there is direct sale of goods by the producer to the consumer. This direct contact with the consumer can be made through door-to-door salesmen, own retail outlets or even through direct mail. Also in case of perishable products and certain technical household 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. 1.5

(b) One stage channel of distribution



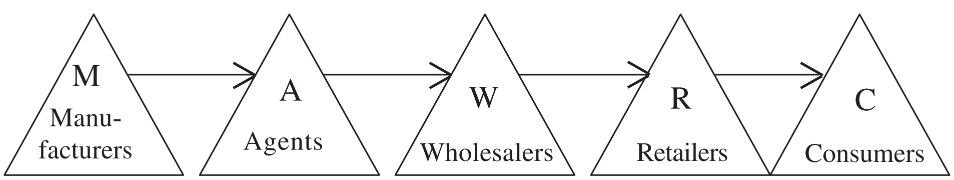
In this case, there is one middleman i.e., the retailer. The manufacturers sell their goods to retailers who in turn sell it to the consumers. This type of distribution channel is preferred by manufacturers of consumer durables like refrigerator, air conditioner, washing machine, etc. where individual purchase involves large amount. It is also used for distribution through large scale retailers such as departmental stores (Big Bazaar, Spensors) and super markets. 1.5

(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. 1.5

(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. 1.5 6

28. **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

$$\text{Return on Equity Share Capital} = \frac{75,00,000}{2,50,00,000} \times 100 = 30\%$$

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

$$\text{Return on Equity Share Capital} = \frac{60,00,000}{1,00,00,000} \times 100 = 60\%$$

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%. 6 6

OR

Following are the factors that effect the determination of working capital requirement :

(a) Nature of business 1

(b) Size of business 1

(c) Length of production cycle 1

(d) Inventory turnover rate 1

(e) Credit policy 1

(f) Seasonal Fluctuations 1 6

29. 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. 1

(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. 1

(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. 1

(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. 1

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. 2 6

OR

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. 0.5

2. **Instruction Card Clerk :** He lays down the instructions for workers, who have to follow them to perform their jobs. 0.5

3. **Time & Cost Clerk :** He sets the time table for doing various jobs and specify the labour cost and material cost for each operation. 0.5

4. **Shop Disciplinarian :** He has the responsibility to maintain discipline in the factory. 0.5

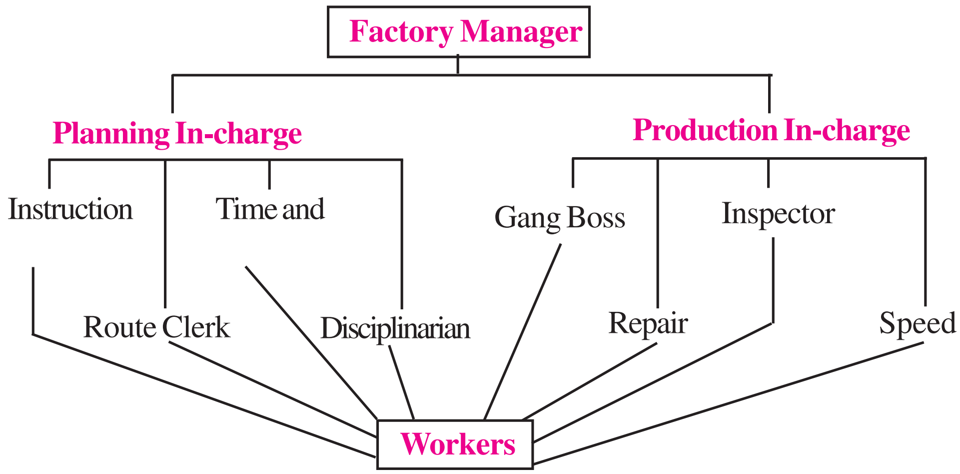
Foremen under Production Department are :

1. **Gang Boss :** He arranges workers, machines, tools and materials etc. for the jobs. 0.5

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. 0.5

3. **Repair Boss :** He has the responsibility of maintaining (cleaning, greasing, oiling etc.) the machines, tolls and equipments. 0.5

4. **Inspector :** He has to ensure that output agrees to the standards of quality set by the planning department. 0.5



2 6

30. (a) Screening the applications 1

(b) Holding tests 1

(c) Selection interview 1

(d) Checking references 1

(e) Medical examination of the candidates 1

(f) Issue of appointment letter 1 6

OR

Importance of Leadership

• leadership improves the performance of the employees. Leaders can motivate the followers to work and thereby increase their performance level.	2	
• with continuous support and guidance, leaders are able to build confidence among the followers, thereby increasing speed and accuracy and decreasing wastage.	2	
• with friendly and cooperative efforts the leader is able to build employees' morale which in turn contribute to higher productivity.	2	6

Awards Won by NIOS

Several projects have been implemented by the NIOS to tap the potential of Information and Communication Technology (ICT) for promoting of Open and Distance Learning (ODL) system. The Ni-On project of NIOS won the National Award for e-governance and Department of Information and Technology, Govt. of India. In further recognition of its On-line initiatives and best ICT practices, the NIOS received the following awards:

NIOS WINS National Award for e-Governance 2008-09

Silver icon for Excellence in Government Process Re-engineering, Instituted by Government of India Department of Administrative Reforms and Public Grievances & Department of Information Technology.

NIOS receives NCPEDP MPHASIS Universal Design Awards 2012

National Institute of Open Schooling (NIOS) has been awarded THE NCPEDP - MPHASIS UNIVERSAL DESIGN AWARDS 2012 instituted by National Centre for Promotion of Employment for Disabled People. The award was given by **Sh. Mukul Wasnik, Hon'ble Minister for Social Justice and Empowerment, Govt. of India** on 14th August, 2012. NIOS has been selected for its remarkable work done for the learners with disabilities through ICT by making its web portal www.nios.ac.in completely accessible for such learners.

The Manthan Award South Asia & Asia Pacific 2012

The Manthan Award South Asia & Asia Pacific 2012 to recognize the best ICT practices in e-Content and Creativity instituted by Digital Empowerment Foundation in partnership with World Summit Award, Department of Information Technology, Govt. of India, and various other stakeholders like civil society members, media and other similar organisations engaged in promoting digital content inclusiveness in the whole of South Asian & Asia Pacific nation states for development. The award was conferred during **9th Manthan Award Gala South Asia & Asia Pacific 2012 at India Habitat Centre on 1st Dec. 2012.**

Student Feedback Form

Senior Secondary Course

Name..................................   Enrolment No.....................

Subject: Business Studies (319)   Book No: 2

Dear Learner,

We, at the National Institute of Open Schooling, are always trying to make our courses relevant to your needs. In order to get appropriate feedback from you so that we can improve the study material accordingly, we are enclosing this form. Please fill in the form and post it back to us at the following address:

Director (Academic)
National Institute of Open Schooling
A-24/25, Institutional Area,
Sector 62, NOIDA-201307 (U.P)

1. When did you receive the study material (indicate month and year)?

   ☐ Month   ☐ Year

2. How much did you use the material? (Mark ✓against the most appropriate one)

   Extensively ☐   Selectively ☐

   Not much ☐   Not at all ☐

3. How much time (in hours) do you spend every day for study? ☐

4. Did you find the material useful? (Mark ✓ against the most appropriate one)

   Very much ☐   To some extent ☐   Very little ☐

5. What other reference material do you consult?

Title	Publishers

6. Classify all the lessons in the following table:

(You may attach extra sheet, if space is not sfficient)

Lesson No.	Lesson Name	Interesting	Easy	Difficult

7. Which sections/lessons do you think need more explanation, examples or illustrations?

____

____

8. Indicate the **"Intext Questions"** number and the question number(s) you found difficult to answer.

____

____

9. Could you answer the **"Terminal Questions"** of all the lessons? Yes/No

10. Was any of the question difficult to answer? Yes/No

If yes, indicate the lesson number and the question number?

____

____

11. Does the summary **“What You Have Learnt"** given at the end of each lesson help you to recapitulate the lesson? Yes/No

12. Which format of **"What You Have Learnt"** did you like best? (Please tick mark)

- Point wise ☐
- Flow chart ☐
- Given in a paragraph ☐

13. Did you remember the Key Terms given at the end of each lesson? Yes/No

14. Did you find the "**Do and Learn**" section interesting and useful? Yes/No

15. How did you like the section "Role Play"?

____

____

____

16. Did you aware about the electronic media programmes of NIOS which may be used alongwith the print material? Yes/No

17. Do you watch NIOS video programmes telecast on Gyan Darshan everyday from 06:30pm to 07:00pm and on DD-I every Friday from 05:02 to 05:25 am? Yes/No

18. If No, why?

Non availability of the telecast ☐
Not aware about it ☐
Not useful ☐
Timing is not suitable ☐

19. What is your opinion about these programmes?

____

____

20. Did you complete the Sample Question Paper independently? Yes/No

21. Did you face any difficulty in doing the Question Paper? Yes/No

22. If yes, please specify your difficulties.

____

____

Any other things you would like to share with us: ______________________________

____

____

Success Stories

Kavya Madhavan
Enrolment No. 090008103065

Kavya Madhavan is a highly acclaimed actress in the Malayalam film world. Making her debut as a child artiste, Kavya quickly managed to find a place in the hearts of malayalees. However, all this was at the cost of dropping out of school at the Secondary level. Like many others, she too nurtured a dream of acquiring a college degree. Motivated to join the National Institute of Open Schooling (NIOS), Kavya Madhavan appeared for the Senior secondary level examination in Malayalam medium and emerged successful. But this was not achieved easily, she says.

Thanks to the Open Schooling system, Kavya Madhavan has now registered for B.Com in M.G. University, Kottayam, Kerala.

Ganesh
Enrolment No. Secondary Course: 25001292005
Senior Secondary Course: 250012103570

Ganesh has cleared the Secondary course of NIOS with first division and has now appeared in 4 subjects of Senior Secondary course. What differentiates Ganesh from other students is that he is suffering from a non-healing ulcer of bone infection. There is no treatment for his ailment; his lower part below the belt has not grown. The puss leaks from his body continuously. He cannot move, and even has no sensation in the lower part of his body. He has to be carried to be moved from one place to another.

However, support from his family members and the Chief Commissioner of Disabilities facilitated his enrolled as a student under Sarva Shiksha Abhiyan as a private candidate, thereby enabling him to clear Class 5 and Class 8. It was at this point that NIOS came to his rescue by providing the flexibility of studying at his own pace through credit accumulation. He could also study subjects of his own choice and was further allowed to appear for the examination in his house. UT Chandigarh continued to support him by providing him with the facility of tutors, who taught him Maths and Science.

With a keen interest in religion, he has read about the various *Puranas, Ramayana* etc., from which he has derived a lot of internal strength.

Ganesh is certainly determined to study further and wishes to pursue a course in Computer Science after clearing his Senior Secondary course from the NIOS.