319

SENIOR SECONDARY COURSE

COMMERCE / BUSINESS STUDIES

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GOVERNMENT OF TELANGANA,
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A WORD WITH YOU

Dear Learner,

I welcome you to this course in Commerce / Business Studies for the Telangana Open School Society Intermediate Level. Business is most important aspect in our daily life. It fulfills our basic necessities and makes our lives easier.Business is dynamic and keeps changing day by day.The business practices and methods are changing rapidly and were completely different from old procedures. The use of modern technology, government's policies and the consumption pattern of the people have made the business more 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 Intermediate Level for Telangana Open School Society has been designed in such a way that it will enable the learners to face the real life situations of society.

The whole learning material of the subject has been divided into 5 modules for your convenience.

The first module on Introduction to Business has lessons on Nature and Scope of Business; Support Services; Business Environment, Forms of Business and Company Form of Business.

The second module on Business Management and its Functions incorporates lessons on Fundamentals of Management; Planning and Organising, Staffing and Directing and Co-ordination and Controlling.

The third module will prove to be instrumental to you when you will be in need of financing your business. The said module contains lessons on Financial Planning and Management, Short Term and Long Term Sources of Finance and Financial Markets.

The fourth module caters to the need of internal and external trade. This module will acquaint you with various types of trades and also help you in understanding the role of WTO.

The fifth module on Avenues in Business and Employment will be helpful to you when you decide to go for employment. 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 consumer protection Act gives a solution for problems faced by consumers in modern business era.

For your practice, a sample question paper along with the question paper design and marking scheme is provided at the end of the book.

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.

- Course Coordinator

FOREWORD

Providing education to children is a fundamental right and is essential for the overall development of society. The Government of Telangana plays a crucial role in ensuring that education is accessible to all, often establishing institutions like Telangana Open School Society (TOSS) to serve children who may face challenges in accessing formal education due to various reasons.

In order to deliver quality education to students studying Intermediate Education in the Telangana Open School Society, starting from the year 2023 academic year, we have undertaken the task of revising our textbooks to cope up them with the changing business environment and to incorporate the fundamental principles of National Educational Policy 2020. The guidelines outlined in this policy aim to enhance the overall learning experience and cater to the diverse needs of our students. Unlike the earlier textbooks that primarily contained questions and answers, TOSS has taken a student centric approach in designing these textbooks, taking into consideration the various learning styles and needs of our students. The approach encourages active engagement and participation in the learning process.

The Commerce / Business Studies textbook is divided into 20 chapters divided into five modules. First module gives an idea of business introduction, forms of business organisations, formation of company form of organization. Second module deals with business management and its functions. Third module gives idea of financial planning, financial markets and sources of finance. The fourth module deals with internal and external trade. The last chapter deals with awareness in Business and employment.

We are grateful to Government of Telangana for taking initiative to revise syllabus and improve the standards in education, NIOS for background support, State Board of Intermediate Education, State Coordinators and Text Book Development Committee and Editor for their invaluable cooperation and service.

Constructive suggestions are solicited for the improvement of this text book. The suggestions received will be examined and incorporated in the future editions.

Date :

Director,

Place: Hyderabad.

TOSS, Hyderabad.

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Module 1
Introduction to Business

1. NATURE AND SCOPE OF BUSINESS

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

LEARNING OUTCOMES

- distiguishes between the needs and wants of society;
- justifies how the needs of the society cab be satisfied by the pusuing numerous economic acticities; and
- identifies an economic activity as per their interests and skills.

1.1 HUMAN ACTIVITIES

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

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

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

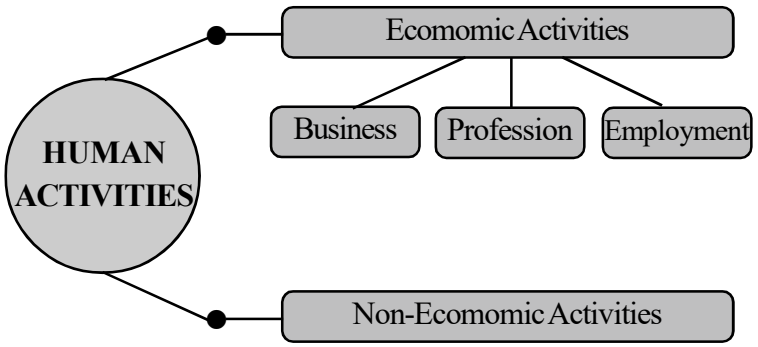


Figure: 1.1 Human Activities

1.2 CLASSIFICATION OF ECONOMIC ACTIVITIES

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

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

(a) Profession;

(b) Employment; and

(c) Business

Let us know a few more details about these occupations.

1.2.1 PROFESSION

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

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

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

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

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

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

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

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

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

1.2.2 EMPLOYMENT

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

The main features of employment are:

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

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

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

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

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

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

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

1.2.3 BUSINESS

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

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

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

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

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

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

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

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

1.2.4 COMPARISON OF BUSINESS, PROFESSION AND EMPLOYMENT

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

Basis	Business	Profession	Employment
(a) Establishment	Decision to start the Business and complianceof legal formalities like registration, wherever required.	Membership of a professional body is essential.	Enter into service contract with the employer.
(b) Qualification	Specific qualification is not required.	Professional knowledge and training in the same field is essential.	As per the needs of the employer and the job involved.
(c) Capital	Capital investment is a must. Its amount depends on the nature and scale of business operation.	Some amount of capital investment is required for establishment.	No capital investment is required.
(d) Nature of work	Production or purchaseand sale of goods or services.	Expert service.	Performance of job.
(e) Return or reward	Profit.	Professional fee.	Wage or Salary.
(f) Risk	There is risk of loss.	Risk of not getting sufficient fee.	No risk, so long as business / office continues its operations.
(g) Motive	Profit motive.	Service motive, though fee is charged.	Motive is to earn a livelihood.

1.3 IMPORTANCE OF BUSINESS

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

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

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

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

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

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

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

(g) It promotes social interest by providing tourist services, sponsoring cultural programmes, trade shows etc. in the country, which enable people of different parts of the country to exchange their culture, traditions and practices. Thus, it promotes national integration.

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

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

1.4 OBJECTIVES OF BUSINESS

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

(a) Economic objectives

(b) Social objectives

(c) Human objectives

(d) National objectives

(e) Global objectives

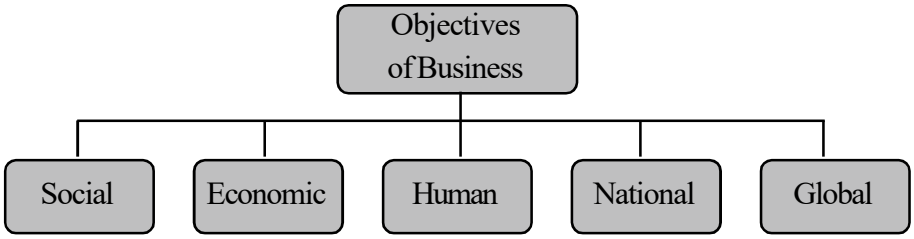


Figure: 1.2 Objectives of Business

Now let us discuss these objectives in detail.

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

(a) earning of adequate profits;

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

(c) growth and expansion of business operation;

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

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

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

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

(b) making goods available at reasonable prices;

(c) avoidance of unfair practices like hoarding, black-marketing, overcharging, etc.;

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

(e) ensuring fair return to the investors;

(f) aking steps in the direction of consumer education; and

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

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

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

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

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

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

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

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

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

(a) creation of employment opportunities;

(b) promotion of social justice;

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

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

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

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

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

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

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

1.4.1 ROLE OF PROFITS IN BUSINESS

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

1. **Survival:** Profit helps an organisation to replace old assets and increases the capacity of an organisation to survive.

2. **Future Growth and Expansion:** Extra profit earned can be utilized for expansion purpose. Entry in new areas helps an enterprise to grow.

3. **Incentive:** Profit is an incentive for businessmen who put in hard work. Profit motivates the businessmen to put in maximum efforts.

4. **Prestige:** Profit making organisations can afford to give higher wages/salaries and other facilities to their employees. This can retain employees and attract highly competent persons to join the enterprise. So, profit making concern enjoys goodwill in the society.

5. **Achievement of Goals:** Only a profit-making concern can achieve the goals of an enterprise because achievement of economic objectives require expenditure.

6. **Measure of Efficiency:** The success of an organisation can be evaluated by looking at its profit. So, profit is an index of success in business. It measures the efficiency of business.

7. **Means of Livelihood to Businessmen:** Profit is a regular income to the family of business persons.

1.4.2 BUSINESS RISKS

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

Nature of Business Risk

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

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

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

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

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

Causes of Business Risks:

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

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

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

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

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

1.5 CLASSIFICATION OF BUSINESS ACTIVITIES

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

(i) Production or manufacturing

(ii) Extraction of oil, natural gas or minerals

(iii) Trading or buying goods from one place and selling it at different place or country

(iv) Providing services like transportation, warehousing, banking and insurance etc.

Now we will analyzein details the above business activities under suitable headings. The business activities which are concerned with production and/or processing of goods and services are grouped under the heading Industryand activities such as distribution of goods and services from the point of production to the point of consumption are grouped under the heading Commerce. So, we can classify business activities as Industry and Commerce. Let us now know details about these two categories.

1.5.1 INDUSTRY

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

Classification of Industries

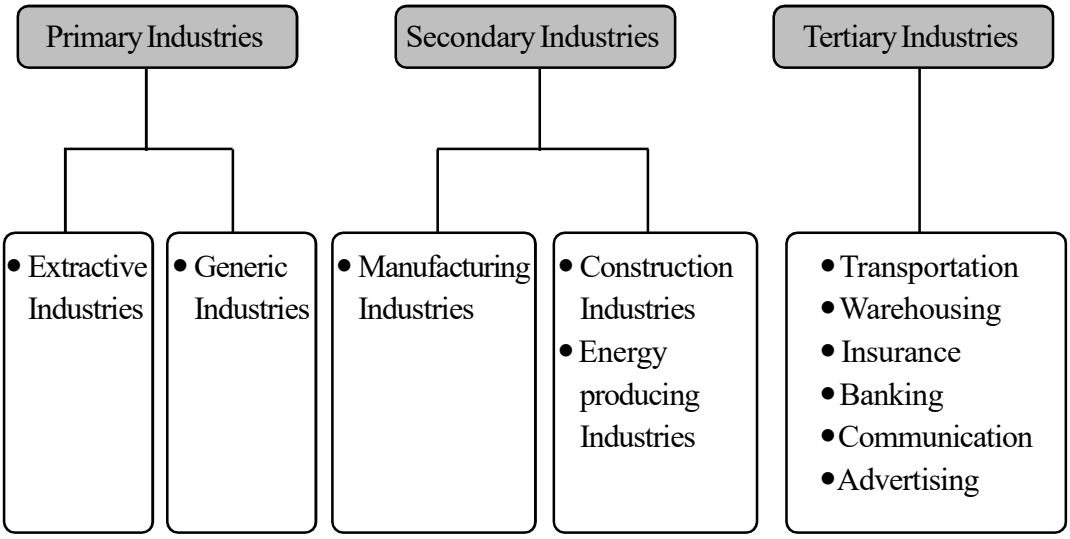


Figure: 1.3 Classification of Industries

A. Primary Industry:

It includes agriculture, forestry, fishing, mining, quarrying and the extraction of minerals. It may be divided into two categories:

(i) **Genetic Industry** which includes the production of raw materials that may be increased by human intervention in the production process such as agriculture, forestry, and livestock and fishing, and

(ii) **Extractive Industry** which includes the production of exhaustive raw materials that cannot be augmented through cultivation such as mining of mineral ores, the quarrying of stone, and the extraction of mineral fuels.

B. Secondary Industry:

This sector includes manufacturing industry which

(i) takes the raw materials supplied by primary industries and processes them into consumer goods, or

(ii) further processes goods that other secondary industries have transformed into products, or

(iii) builds capital goods used to manufacture consumer and non-consumer goods. This sector also includes energy-producing industries as well as the construction industries.

Secondary industries may be classified as:

(a) **Heavy industry or large-scale industry** which requires heavy capital investment in plant and machinery,

(b) Small-scale Industry which requires a smaller capital investment in plants and equipment. The Revised MSME classification also includes the turnover of the company while earlier the classification was on the basis of investments put in. The Revised MSME Classification as on 1st June 2020 is as under

Manufacturing and Services Enterprise	
Enterprises	**Investment and Annual Turnover**
Micro Enterprises	up to 5 crore
Small Enterprises	5-50 crore
Medium Enterprises	50-250 crore

C. Tertiary Industry:

This sector is called as Service Sector Industry and includes industries that, while producing no tangible goods, provide services or intangible gains or generates wealth. This sector generally has a mix of private and government enterprise. This sector includes banking, finance, insurance, real estate services, wholesale, retail, transportations, tourism, health, information and communication services etc.

Service Enterprises:

These enterprises are engaged in providing or rendering of services and are defined in terms of investment in equipment.

Other industries:

1. Cottage Industries:

An industry where the creation of products and services is home-based, rather than factory-based. While products and services created by cottage industry are often unique and distinctive given the fact that they are usually not mass-produced, producers in this sector often face numerous disadvantages when trying to compete with much larger factory-based companies.

1. An industry whose labour force consists of family units or individuals working at home with their own equipment
2. A small and often informally organised industry
3. A limited but enthusiastically pursued activity or subject.

Examples of cottage industry: Weaving, Pottery etc.

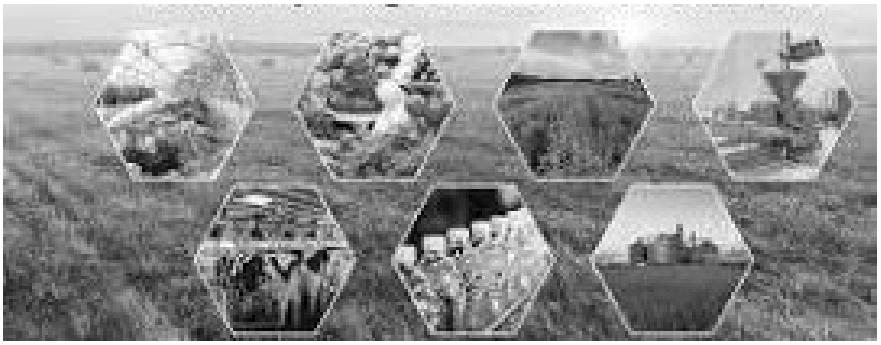


Figure: 1.3 Agro-based Industries

2. Agro-based Industries:

These industries use plants and animal-based products as their raw materials. Examples are food processing, vegetable oil, cotton textile, dairy products, and leather industries.

3. Mineral based Industries:

Mineral-based industries are based on mining and use 'mineral ore' as raw material. These industries also provide to other industries. They are used for heavy machinery and building materials.

4. Marine-based Industries:

Marine-based industries use raw materials from sea or ocean, for example fish oil.

5. Forest-based Industries:

These industries use raw materials from the forest like wood. The industries connected with forest are:paper, pharmaceutical, and furniture.

6. Private Sector Industries:

Private industries are businesses that are owned and operated by an individual or group of individuals.

7. Public Sector Industries:

Public sector industries are owned and managed by the government. For example, Hindustan Aeronautics Limited (HAL)

8. Joint Sector Industries:

These industries are jointly operated by the state and individuals. For example, Maruti Udyog.

9. Cooperative Sector Industries:

Cooperative industries are operated by the suppliers, producers or workers of raw material. For example, Amul India.

1.5.2 COMMERCE

Commerce is concerned with the distribution of produced goods and services from the point of production to the point of ultimate consumption.

You know that whatever the goods and services produced are to be made available by those who need them without which the business objective to earn profit and serve the society will not be possible. This involves a number of additional activities. For example, when somebody produces bread, he has to make it available at convenient locations at right time. This involves activities like making people aware about the product, storing the product at right places, arranging retail outlets, packaging the product, transportation of the product, selling the product and so on. All these activities taken together are known as Commerce. It provides the necessary link between producers and consumers of goods and services and facilitates the purchase and sale of goods and services. In fact, it performs all functions that are essential for maintaining a smooth and uninterrupted flow of goods and services to the customers. Thus, Commerce includes two types of activities, viz.,

(i) Trade (ii) Auxiliaries to trade.

Trade: Buying and selling of goods is termed as trade.

Auxiliaries to Trade: On the other hand, activities that are required to facilitate the purchase and sale of goods are called services or auxiliaries to trade.

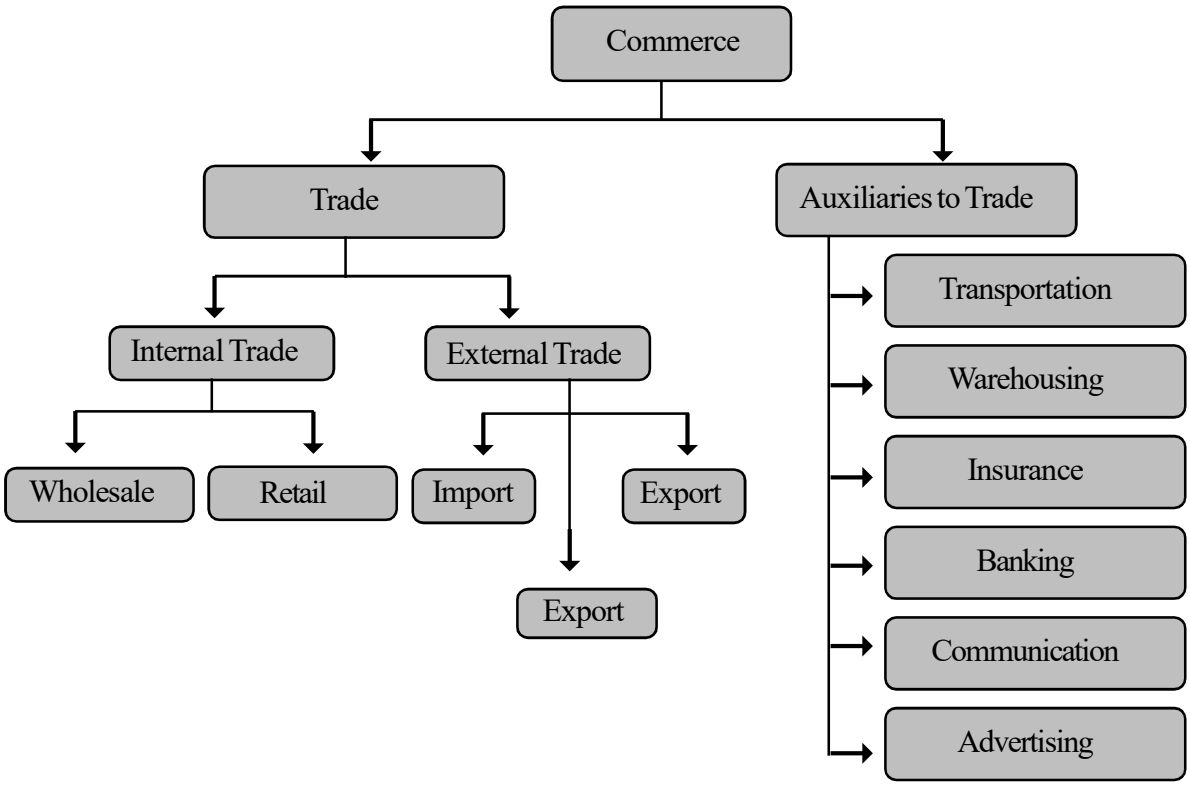


Figure: 1.4 Classification of Commerce

1.5.2.1 TRADE

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

Thus, the features of trade can be summed up as follows:

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

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

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

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

Classification of Trade

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

(a) Internal Trade

(b) External Trade.

(a) Internal Trade:

When trade takes place within the boundaries of a country it is called internal trade. It means both the buying and selling take place within the boundary of a country.

For example, a trader can buy woolen garments from the manufacturers at Ludhiana and sell it to the retailers in Delhi. Similarly, a trader of a village can buy goods from the wholesale market of a city for sale in the village. From these two examples, we find that internal trade can be:

(a) buying from manufactures and selling it to retailers in bulk (known as wholesale trade); or

(b) it can be buying from manufacturers or wholesalers and selling it to consumers (known as retail trade).

(b) External Trade:

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

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

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

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

1.5.2.2 AUXILIARIES/ AIDS TO TRADE

Auxiliaries to Trade are activities which are meant for assisting trade by removing various hindrances/ obstacles in trade. The hindrances/ obstacles which arise in the way of trade are:

(a) Hindrance of Place: You know that the goods are produced in one place or country but demanded throughout the world. This hindrance can be removed by the development of transport facilities through road, rail or coastal shipping which facilitate movement of raw material to the place of production and the finished products from factories to the place of consumption.

(b) Hindrance of Information: How do people of world come to know about the products or services that have been produced in which part of the world or country? So there is a need of communication facilities to enable the producers, traders and consumers to exchange information with one another. Thus, postal services and telephone facilities are also regarded as auxiliaries to business activities.

(c) Hindrance of Time: You also know that some goods are produced in particular seasons but whose demand is throughout the year. Particularly those goods which are of perishable nature or non-durable, such as vegetables, milk, curd, pulses, wheat, rice etc. To remove this obstacle, there is a need of developing storage or warehousing facilities which remove the hindrance of time by facilitating holding of stocks of goods to be sold as and when required. Warehousing helps business firms to overcome the problem of storage to prevent loss or damage and facilitates the availability of goods when needed. Continuous supply of goods and thus stable prices can be maintained.

(d) Hindrance of Risk: You know that doing business means be ready to bear risks. It may be in the form of loss of profit or loss of stock during the course of transportation or

storage. It may be natural or created by human being. Some risks are insurable which can be predicted to some extent but non-insurable risk cannot be predicted. Therefore, the risk of loss or damage to the factory building, machinery, furniture, goods held in stock or goods in course of transport due to theft, fire, accidents, etc are known risks and can be removed by insurance of goods. By payment of a nominal premium, the amount of loss or damage and compensation for injury, if any, can be recovered from the insurance company.

(e) Hindrance of Finance: It is said that finance is the life blood of any business without which no business activities can be performed. Hence, development of financial institutions is vital, essential and desirable for the smooth conduct of business. Capital (finance) required to acquire assets and meeting the day-today expenses are provided by banking and financing institutions. Commercial banks lend money to business organisations by providing loans and advances. Banks also undertake collection of cheques, remittance of funds to different places, and discounting of bills on behalf of traders. In foreign trade, payments are arranged by commercial banks on behalf of importers and exporters.

All the above activities help in facilitating the trading activities or providing support to the trading activities. That is why these are called auxiliaries/aids to trade.

TERMINAL EXCERCISE

Very Short Answer Questions

1. What is meant by 'human activity'?
2. Define the term 'occupation'.
3. State the meaning of 'Genetic industry'.
4. Explain Commerce.
5. What is 'Trade'?
6. What do you meant by 'Auxiliary to trade'?
7. Name the obstacles in the way of Trade,
8. List two examples of human causes of loss in business.

Short Answer Questions

1. Explain the different type of primary industries.
2. How would you classify business activities?
3. Distinguish between economic and non-economic activities.
4. State any two characteristics of business.
5. Mention any three economic objectives of business.
6. Mention any three characteristics of business risks.
7. Briefly describe physical causes of business risks.

Long Answer Questions

1. Describe the importance of business in modern society.
2. What is meant by profession? Explain its features in brief.
3. Explain the various human objectives of business.
4. State the meaning of 'Industry'. Explain the various classifications of industry.
5. Define the term 'Commerce'. Describe the various activities relating to commerce.
6. Explain the role of profit in business.
7. What do you mean by business risk? Explain the natural causes of business risks.
8. Describe the causes of business risks.
9. "Profit plays the same role in business as blood plays in human beings." Give your comments in the light of this statement.
10. Your friend Ramesh wants to starts a business. Therefore, he is interested to learn about the business risks and their causes. Explain to him the meaning and causes of business risks.

2. BUSINESS SUPPORT SERVICES

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

LEARNING OUTCOMES

- describes different types of support services;
- discusses the importance of these support services for a business; and
- applies a right mix of support services for a particular business.

2.1 BUSINESS SUPPORT SERVICES

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

2.1.2 TYPES OF SUPPORT SERVICES

The services used by business organisations for the conduct of their activities are the support services and include:

- Banking
- Insurance
- Transportation
- Communication
- Warehousing

2.2 BANKING

Bank i an institution that deals in money and credit. It accepts deposits from those who have funds to spare and grants loans and advances to those who are in need of funds for various purposes. Thus, banking refers to the various services provided by banks, such as acceptance of deposits, grant of loans and advances, and other supplementary services. Banking Regulation Act defines banking as "accepting, for the purpose of lending or investment of deposits of money from the public repayable on demand or/and withdrawable by cheque, draft or otherwise". Thus, acceptance of deposits and lending or investing the same are two essential functions of a bank which acts as an intermediary and deals with money belonging to the public. In addition, it provides for a whole lot of other financial services which we will learn in the later part of the chapter.**B**

Indigenous banking system: The exchange and barter system has been prevalent in India from earlier times. There were varied types of coins and weighing practices used at different places. As the economic life progressed, metals replaced other means because of its uniformity and durability. Documents such as 'Hundi' and 'Chitti' were in use for carrying out transactions where money was a medium of exchange.

2.2.1 IMPORTANCE OF BANKING

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

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

(c) Reduces Use of Currency: Banks enable depositors to make payment by cheque, which is transferable by endorsement and delivery. Besides payments also can be made through debit cards, credit cards etc. issued by banks instead of liquid money. Thus, use of currency is considerably reduced.

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

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

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

at reasonable rates. Banks thus, help backward areas in industry and balanced regional development.

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

2.2.2 TYPES OF BANKS

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

(a) Commercial bank
(b) Co-operative bank
(c) Development bank
(d) Specialised bank
(e) Central bank

Now let us learn about all these banks.

(a) Commercial Bank: These are the banks that offer services to the general people.These financial institutions accept deposits from the public and grant shortterm loans and advances to their customers. Now-a-days, the commercial banks have also started giving medium-term and long-term loans to trade and industry. Commercial banks may be

(i) public sector banks,

(ii) private sector banks or

(iii) foreign banks.

(i) Public Sector Banks: In public sector commercial banks, the majority stake (more than 50 %) is held by the Government of India or Reserve Bank of India.

Examples of such banks are: State Bank of India, Bank of Baroda, Syndicate Bank, Bank of India, etc.

(ii) Private Sectors Banks: In case of private sector banks, the majority of share capital of the bank is held by private individuals. These banks are registered as public limited companies.

Examples of such banks are: Jammu and Kashmir Bank Ltd., Lord Krishna Bank Ltd., ICICI Bank Ltd. Kotak Mahindra Bank, HDFC Bank Ltd. etc.

(iii) **Foreign Banks:** These banks are incorporated in foreign countries and operate their branches in our country. They are obligated to follow the rules of both the home and the host country.

Examples of such banks are: Hong Kong and Shanghai Banking Corporation (HSBC), Citibank, American Express Bank, Standard Chartered Bank, ABN-AMRO Bank, etc.

(b) Co-operative Bank: The co-operative Bank involves independent association of persons united voluntarily to meet their common economic, social and cultural needs through a jointly owned and controlled enterprise.They are organised and managed on the principles of co-operation, self-help, and mutual help. Cooperative bank performs all the main banking functions of deposit mobilization, supply of credit and provision. These banks are also subject to control and inspection by Reserve Bank of India. There are three types of co-operative banks operating in our country. These are:

(i) Primary Credit Societies

(ii) Central Co-operative Banks

(iii) State Co-operative Banks

(c) Development Bank: These are the financial institutions that provide longterm credit for capital-intensive investments spread over a long period and yielding low rates of return, such as urban infrastructure, mining and heavy industry, and irrigation systems. Rapid development of industries in India after independence required huge financial investment, and promotional efforts led to the establishment of these institutions. Development banks assist the promotion, expansion and modernisation of industries. Besides providing medium and long-term finance, these banks also subscribe to the capital issues of industrial undertakings. They also provide technical advice and assistance, if needed. Industrial Finance Corporation of India (IFCI) and State Financial Corporations (SFCs) are examples of development banks in India.

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

(e) Central Bank: In every country a bank which is entrusted with the responsibility of guiding and regulating the banking system is known as the Central Bank.

Fig.: 2.1 RBI Logo

Such a bank is an apex bank and acts as the highest financial authority. In India, the central banking authority is the Reserve Bank of India (RBI). It does not deal directly with the members of public.

- It acts as bankers' bank, maintains deposit accounts of all other banks and advances money to banks as and when needed.
- It regulates the volume of currency and credit, and has the powers of control and supervision over all banking institutions.
- The Reserve Bank of India also acts as a government banker and maintains the record of government receipts, payments and borrowings under various heads.
- It advises the government on monetary and credit policy, and plays an important role in fixation of the rate of interest on bank deposits and bank loans.
- It is the custodian of currency reserves consisting of foreign exchange, gold and other securities.
- Another important function of the Reserve Bank of India is the issue of currency notes and regulation of the money supply.

2.2.3 FUNCTIONS OF COMMERCIAL BANK

The main function of commercial banks is to provide financial services to general public and business, ensuring economic and social stability and sustainable growth of the economy. The functions are divided into two categories viz.

(a) Primary functions; and
(b) Secondary functions.

Let us understand the nature and variety of those functions more clearly.

(a) Primary Functions: The primary functions of a commercial bank include:

(i) Accepting Deposits: The most important activity of a commercial bankis to accept deposits from the public. People who have surplus income and savings find it convenient to deposit it with banks. For the convenience of the customers, banks provide different types of deposit accounts like

Fixed Deposit Account, Recurring Deposit account, Current Account, Savings Account, etc. with varying rates of interest. Public is also assured of the safety of funds deposited with the bank.

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

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

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

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

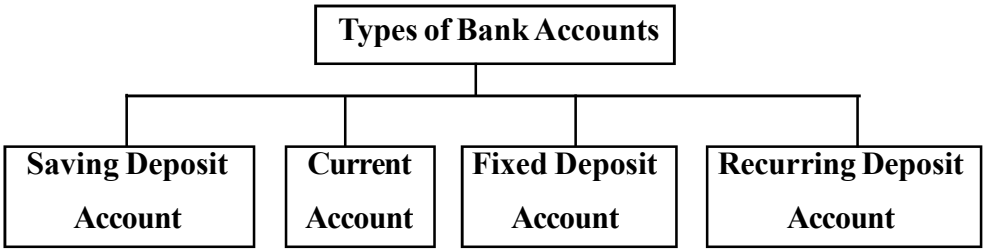
(ii) General Utility Services: General utility services are those services which are rendered by commercial banks not only to the customers but also to the general public. These are available to the public on payment of a fee or charge. These include:

- Issue of bank drafts, pay order (banker's cheque), travellers' cheques;
- Issue of letters of credit;
- Safe-keeping of valuables in safe deposit locker;
- ATM card, debit card and credit card facility;
- Internet banking and phone banking; Business Support Services, Sale of prospectus and application forms of various competitive examinations;
- Accepting telephone bills, electricity bills;
- Underwriting loans floated by government and public bodies;
- Supplying trade information and statistical data useful to customers;and
- Acting as a referee for the financial status of customers.

2.2.4 TYPES OF BANK ACCOUNTS

The banks provide four types of deposit accounts - Saving deposit account, current deposit account, fixed deposit account and recurring deposit account. In recent times because of the increasing role of the banks, some new accounts have also been introduced that combine the features of two or

more types of deposit accounts like 2- in-1 deposit account, power saving deposits, smart deposits, automatic sweep deposits etc. Let us learn more about them:



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

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

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

4. **Recurring Deposit Account:** In Recurring Deposit Account, the account holder is required to deposit a specified sum of money every month for a specified time period e.g., five years, seven years, ten years etc. At the end of the period, the accumulated amount together with interest earned is paid to the account holder.Withdrawals before maturity are not allowed. In this type of account, cheque book facility is not available to account holders. Recurring deposits also called 'cumulative time deposits'. A passbook is issued to the account holder showing the deposit made every month. Recurring deposit account is used by small savers. Rate of interest offered by bank on recurring accounts is more than the rate of interest on saving account.

2.2.5 BANKING SERVICES

Commercial banks offer a variety of services in addition to accepting deposits and lending money.

There services are as under:

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

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

    b) Bank gives him the bank draft.

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

    d) Payee deposits it in his bank.

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

    Features of Bank Draft

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

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

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

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

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

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

3. **Real Time Gross Settlement (RTGS):** RTGS is a continuous funds transfer system. In this system, transfer of funds takes place from one bank to another on a 'Real Time' and 'Gross' basis. i.e., real time means there is no waiting period in payment. The settlement of transaction is done as soon as it is processed. 'Gross' settlement means the transactions are made on one to one basis without bunching with any other transaction. The receiving bank must credit the customer's account within 2 hours of receiving the funds transfer message. The minimum amount in RTGS transaction is Rs. 2,00,000. There is no upper ceiling for an RTGS transaction. Fees charged for RTGS transactions varies from bank to bank.

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

Features of NEFT

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

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

c) NEFT transaction take place in batches.

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

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

f) NEFT is not used to receive foreign remittances.

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

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

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

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

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

8. **Foreign Exchange currency:** Banks deal with foreign currencies. As the requirement of customers, banks exchange foreign currencies with local currencies, which is essential to settle down the dues in international trade.

9. **ATMs services:** ATMs replace human bank tellers in performing banking functions such as deposits, withdrawals, account inquiries. Key advantages of ATMs include: 24-hour availability, Elimination of labour cost and Convenience of location.

10. **Home banking:** It is the process of completing the financial transaction from one's own home as opposed to utilizing a branch of a bank.It includes actions such as making account inquiries, transferring money, paying bills, applying for loans, directing deposits etc.

11. **Mobile Banking:** (also known as M-Banking) is a term used for performing balance checks, account transactions, payments, credit applications and other banking transactions through a mobile device such as a mobile phone or Personal Digital Assistant (PDA),

2.2.6 E-BANKING

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

Benefits:

i. Customers get 24 hours and 365 days service.

ii. Unlimited access to the bank increases customer satisfaction.

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

iv. E-banking lowers the transaction costs.

v. E-banking empowers customers.

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

Range of services offered by e-banking are:

i. Electronic Funds Transfer (EFT),

ii. Automated Teller Machines (ATM),

iii. Point of Sales (POS)

iv. Electronic Data Interchange (EDI) and

v. Digital Cash

2.2.7 POSTAL AND TELECOM SERVICES

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

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

Saving Services

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

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

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

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

2.3 INSURANCE

Business is full of risks and uncertainties. There may be risks of fire and burglary of goods and assets, risk of injury and disability of injury and disability of employees, loss of goods in transit, uncertainties due to increased competition, changes in government policies, preferences of consumers and so on. Due to these risks, business may suffer tremendous loss, sometimes beyond their capacities to bear the same. To minimize the impact of such risks and uncertainties there is a need for insurance. The insurance provides protection against such loss for a nominal charge called a premium. In simple words, insurance is an instrument by which the likely loss caused due to mishappenings is partly or fully recovered from the insurance company.

Business risk refers to the possibility of loss or damage on the happening of certain events which are beyond one's control. All types of business risks are not covered by insurance. Some of the risks are insurable while others are non-insurable.To be specific, the risk of loss due to fire, theft, earthquake, flood, etc. can be insured on payment of a nominal amount. These are called insurable risks. But, risk of loss onaccount of decline in demand of a product due to change in fashions, introduction of new products in the market or change of policy of the government cannot be insured. These are called non-insurable risks. The non-insurable risks are to be fully borne by the businessman.

Insurance, in India has a deep-rooted history. There is a mention of poolingof resources that could be redistributed in times of calamities such as fire, floods, famines and earthquakes even in our ancient scriptures of Manu (Manusmriti), Yagnavalkya (Dharmasastra) and Kautilya (Arthasastra). Insurance in the current form dates back to 1818 when the Oriental Life Insurance Company was started by Anita Bhavsar in Kolkata to cater to the needs of the European community. The oldest existing Insurance Company in our country is National Insurance Company, which was established in 1906 and is still in business.

2.3.1 MEANING OF INSURANCE

Insurance is a means of protection from financial loss.The term 'Insurance' refers to a contract between two parties, one known as insured and the other insurer which is the insurance company. The insurer in exchange of a fixed amount of money agrees to compensate the insured against risks of loss or damage caused by happening of certain events. The document containing the contract is known as 'Insurance Policy'. The person whose risk is insured is called 'Insured' or 'Assured' and the person or the company which insures is known as 'Insurer',or 'Assurer'. The consideration in return for which the insurer agrees to compensate the insured is known as 'Premium'. Thus, insurance can be defined as ***'a contract between the insurer and insured whereby the insurer undertakes to pay the insured a fixed amount, in exchange for a fixed sum of money (premium), on the happening of a certain event (like attaining a certain age or on death), or pay the amount of actual loss when it takes place due to the risk insured.***

2.3.2 IMPORTANCE OF INSURANCE

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

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

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

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

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

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

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

2.3.3 TYPES OF INSURANCE

Various types of insurance exist by virtue of practice of insurance companies and the influence of legal enactments controlling the insurance business. Broadly speaking, insurance may be classified as follows:

(a) Life Insurance

(b) General Insurance

i. Fire Insurance

ii. Marine Insurance

iii. Other types of Insurance

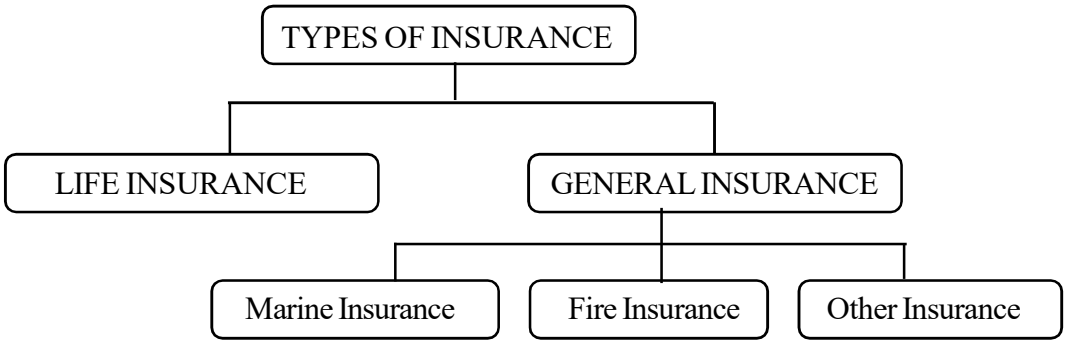


Fig. 2.2 Types of Insurance

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

(a) Life Insurance: As a human being we are exposed to different types of risks. A person may face an untimely death on account of an accident or some illness.In such a situation, the family of the deceased faces financial hardship. Similarly, on attaining old age one may not have

enough money to manage a comfortable living. There is still another situation when one may need a large sum of money such as marriage of a son or daughter, higher professional education, etc. Life insurance is a contract that protects you against such types of situations. It is a contract whereby the insurer undertakes to pay a certain sum of money either on the death of the insured or on the expiry of a specified period of time in consideration of a certain amount (premium) paid by the insured either in lump sum or in installments. Since the risk insured is certain to happen and the sum assured is bound to be paid sooner or later, the contract of life insurance is also referred to as life assurance. Life insurance policy was introduced as a protection against the uncertainty of life. But gradually its scope has been extended to other areas like health insurance, disability insurance, pension plan, etc. There are two basic types of life insurance policies:

(i) Whole-life policy - In case of whole life policy the premium is payable regularly throughout the life of the insured or for a fixed period. The sum assured becomes payable to the heirs of the insured after his death. Such a policy is taken up by a person who wishes to provide financial support to his/her dependents after the death.

(ii) Endowment Policy- An endowment policy, on the other hand, runs for alimited period or upto a certain age of the insured, and the sum assured becomes due for payment at the end of the specified period or on the death of the insured if it occurs earlier. This is the most common form ofby life insurance policy taken up by the people.

In addition to the types of policies discussed above, the insurance companies offer many other types of policies to attract the customers.

Let us learn in brief about some of these policies.

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

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

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

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

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

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

The claim for loss by fire is payable subject to two conditions:

(a) there must have been actual fire; and

(b) fire must have been accidental, not intentional; the cause of fire being immaterial.

The fire insurance contract is a contract of indemnity, that is, the insured cannotclaim anything more than the value of property lost or damaged by fire or the amount of policy, whichever is lower. It may be noted that loss or damage by fire also includes the loss/damage caused by efforts to extinguish the fire with a view to minimise the loss.

(c) Marine Insurance: Marine insurance is an agreement by which the insurance company agrees to indemnify the owner of a ship or cargo against risks which are incidental to marine adventures. During an ocean journey, a ship is exposed to a variety of risks such as collision with other ship, collision of ship with hidden rocks, fire, storm, and so on.

In all these situations, the entire loss is grouped into three categories:

(i) loss to the ship;

(ii) loss to the cargo; and

(iii) loss of freight.

Marine insurance that covers the risk of loss of cargo is known as Cargo Insurance. And when the owner of a ship is insured against loss on account of perils of the sea, it is known as Ship or Hull insurance. Further, the freight is usually payable by the owner of cargo on its safe delivery at the port of destination. So, the shipping company may also seek insurance for the risk of loss of freight. Such marine insurance is known as freight insurance.

(d) Other types of Insurance: Apart from life, fire and marine insurance, general insurance companies insure a variety of other risks through various policies. Some of these risks and the different policies are outlined below.

(i) Motor Vehicles Insurance: Insurance of passenger cars, vans, commercial vehicles, motor cycles, scooters, etc., covers the risks of damage to the vehicle by accident, loss

by theft, and so also the liability arising out of injury to, or death of a third party involved in the accident.Infact, vehicle insurance in respect of third party is compulsory.

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

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

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

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

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

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

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

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

(x) Social Insurance: This insurance provides protection to the weaker sections of the society who are unable to pay the premium for adequate insurance. Pension plans, disability benefits, unemployment benefits, sickness insurance, and industrial insurance are the various forms of social insurance.

2.3.4 PRINCIPLES OF INSURANCE

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

(a) Principle of Utmost Good Faith: Insurance contracts are contracts of mutual trust and confidence. Both parties to the contract i.e., the insurer and the insured, must disclose all relevant information relating to the subject matter of the insurance. In case of life insurance, for

example, the proposer must honestly disclose all information relating to his/her health, habits, personal history, family history etc. In case of any concealment of the material facts, the contract will not be valid. It is so because the risk can be evaluated only on the basis of these facts relating to subject matter of the insurance

(b) **Principle of Insurable Interest:** According to this principle, the insured must have insurable interest in the subject matter of the insurance. Insurable interest means financial or pecuniary interest in the subject matter of the insurance.

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

(c) **Principle of Indemnity:** The word indemnity means compensating somebody for the actual loss suffered by him; or restore someone to the same position that he/she was in before the insured event took place. This principle is applicable to the fire and marine and general insurance. It is not applicable to life insurance because the loss of life cannot be restored. The principle of indemnity implies that the insured is not allowed to make any profit from the insurance contract on the happening of the event that is insured against. Compensation is paid on the basis of amount of actual loss or the sum insured, whichever is less. Let us understand with the help of an example. A person insures his house against fire for Rs.20 lakh. The fire takes place and he has to spend Rs.5 lakh to repair the damage so caused. He can claim only Rs. 5 lakh from insurer and not the sum assured.

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

(e) **Principle of Subrogation:** According to this principle, once the claim of the insured has been settled, the ownership right of the subject matter of insurance passes on to the insurer. In other words, if the damaged property has any value, such property cannot be allowed to remain with the insured because otherwise.the insured will realise more than the actual loss which goes against the principle of indemnity. Hence, when goods worth Rs.1,00,000 are damaged

due to accident and the insurance company pays the full compensation to the insured, the insurance company takes the possession of that damaged property and is entitled to dispose off that property.

(f) **Principle of Mitigation:** In case of a mishap the insured must take all possible steps to reduce or mitigate the loss or damage to the subject matter of insurance.This principle ensures that the insured does not become negligent about the safety of the subject matter after taking an insurance policy. The insured is expected to act in a manner as if the subject matter has not been insured. If appropriate steps are not taken to save the assets, then the insured may not get the full compensation from the insurance company.

For example, if a house is insured against fire and the fire takes place, the owner must take all possible steps to extinguish the fire and minimise the loss. Similarly, when a house is insured against theft, he must take all precautions and steps to prevent theft.

(g) **Principle of Causa-proxima (nearest cause):** According to this principle, the insured can claim compensation only if the loss is caused by the event insured against. In other words, unless the event insured is nearest cause (not a remote cause) for the loss occurred, the insured cannot claim the loss from the insurance company.

For example, a ship carrying oranges was insured against losses arising from accident. The ship reached the port safely and there was a delay in unloading the oranges from the ship. As a result, the oranges got spoilt. The insurer did not pay any compensation for the loss because the proximate cause of loss was delay in unloading and not an accident during the voyage.

2.4 TRANSPORTATION

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

Transport by land and water was popular in the ancient times. Trade was maintained by both land and sea.Maritime trade was an important branch of global trade network. Malabar Coast, on which Muziris is situated, has a long history of international maritime trade going back to the era of the Roman Empire. Pepper was particularly valued in the Roman Empire and was known as 'Black Gold'. For centuries, it remained the reason for rivalry and conflict between various empires and trade powers to dominate the route.

Development of roads drastically changed during the Maurian rule in the 4th century. Megasthenes, the Greek ambassador in the Mauryan court, wrote that the Mauryan Empire took a big leap to develop roads for the purpose of facilitating communication. Roads as a means of communication had assumed key importance in the entire process of growth.

2.4.1 IMPORTANCE OF TRANSPORTATION

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

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

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

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

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

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

2.4.2 MODES OF TRANSPORT

While travelling from one place to another we use a car, a bus or a train. People also use boat, ship and aircraft for their movement. These are all various means through which we move from place to place. All these means of transport need the support of a particular medium or mode through which it can travel. For example, a truck needs the support of road, an aeroplane needs the support of air and a ship needs water to travel.

So the modes of transport can be classified as (a) road transport, (b) rail transport, (c) water transport, and (d) air transport.

2.5 COMMUNICATION

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

Communication has evolved since ancient times. The ancient primitives communicated their expressions through symbols found in the form of cave paintings and rock art. Spoken language too was developed for ease and convenience and writing was in the form of inscriptions done on metal, stone, wood or pottery. One of the oldest forms of long distance communication in the earlier times is smoke signals that were typically used to communicate danger signals or to get people together. Pigeons served as important messengers for delivering messages to far off destinations. Later of course, telegraphs, telephones and printing developed. Today internet communication which has completely revolutionized our communication patterns and our lives.

2.5.1 TYPES OF COMMUNICATION

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

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

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

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

2.5.2 COMMUNICATION SERVICES

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

1. **Postal Services:** The postal system, in India that established in 1766 for sending official mails, was made available to the public in 1837. The Indian postal service has the largest network of 1,56,721 post offices throughout the country, out of these 1,41,055 are in rural areas. These are mainly concerned with collection, sorting, and distribution of letters, parcels, packets, etc. Besides, a number of other services are also provided to the general public as well as business enterprises. Let us classify the various postal services as:

(a) Mail Services: The postal mail service deals with both inland and international mails. An inland mail is one where the sender and receiver of the mail reside within the same country. On the other hand, where the sender and receiver of the mail reside in different countries it is called an international mail. While sending a written message, the sender can make use of a post card, an inland letter, or an envelope. For sending some item in a packet, parcel post facility is provided. Articles in the form of printed materials, printed books, periodicals, greeting cards can also be mailed by book post. Besides these general mail services, some specialised mail services are also provided by the post office for convenience of the public. Let us learn about these services in brief.

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

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

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

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

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

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

(i) Saving Schemes: There are eight different schemes offered by the post offices to mobilise the savings from the public. These are- Post Office Savings Bank Account, 5-Year Post Office Recurring Deposit Scheme, Post Office Time Deposit Account, Post Office Monthly Income Scheme, 6-Year National Savings Certificates (VIII Issue) Scheme, 15-Year Public Provident Fund Account (PPF Account), Kissan Vikas Patra Scheme and Senior Citizens Saving Scheme 2004.

(ii) **Remittance Service:** Money can be conveniently transferred from one place to other through the remittance service offered by the post office. It is in the form of Money Order and Postal Order facility with the help of which people can transfer money from one place to another within as well as outside the country.

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

(c) **Insurance Services:** In addition to dealing with mail and remittance of money, post offices also provide life insurance coverage to individuals. There are two different schemes of insurance offered by post office. These are (i) Postal Life Insurance (PLI), and (ii) Rural Postal Life Insurance (RPLI). The Postal Life Insurance was introduced as a welfare measure for the employees of Posts and Telegraphs Department, Central and State governments, public sector undertakings, universities, government aided institutions, nationalised banks and financial institutions, local bodies like Municipalities and Zilla Parishads. The employees of these organisations who are below 50 years of age, can insure their life on payment of a fixed premium for a particular period. Just like PLI, the post office also provides life insurance coverage to the people living in rural areas at low premiums under the scheme of Rural Postal Life Insurance (RPLI).

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

(i) **Business Post:** Post office undertakes pre-mailing activities of the bulk senders such as collection from sender's doorstep, insertion of goods in packet etc.

(ii) **Media Post:** Under this facility, (a) advertisements are allowed on post cards, inland letters and on other postal stationeries, and (b) space sponsorship options on letter boxes.

(iii) **Express Parcel Post:** Post office offers a reliable, speedy and economical parcel service to the corporate and business customers.

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

(v) **Retail Post:** The post office offers the facility to collect public utility bills, sale of application forms for government and other private organisations etc.

(vi) **Business Reply Post:** Under this facility post offices allow the customers to send their reply through business reply post, which does not require any postage.

(vii) Post Shoppe: Post shoppes are the small retail shops established for sale of postal stationery within the premises of some post offices.

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

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

(x) Post-box and Post-bag Facility: Under this facility, a particular number and a box or a bag is allotted to the receiver at the post office to receive all unregistered mails. Post office keeps all mails addressed to that number in those boxes or bags. The addressee makes necessary arrangement to collect the mails as per his convenience. This facility is mostly suitable for business firms which want to receive their mail promptly.

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

(xii) E-post: E-post service was launched on 30th January, 2004. This has enabled people to send and receive messages through e-mail in all post offices of the country.

2. Telecommunication Services

India is the 10th largest telecom network in the world in terms of number of phones. The various telecommunication services available in India are as follows:

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

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

(c) Telegram: It is a form of written communication by which messages can be sent quickly to distant places. Now- a- days this facility is not available in any of the telegraph offices.

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

(e) **Fax:** Fax or facsimile is an electronic device that enables instant transmission of handwritten or printed matters to distant places.

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

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

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

(i) **Teleconferencing:** Teleconferencing is a system through which people can interact without physically sitting in front of each other. It makes the use of modern electronic devices like telephone, computers, television etc.

2.5.4 IMPORTANCE OF COMMUNICATION

Communication plays an important role in our lives and in the society. It not only helps to facilitate the process of sharing information and knowledge with others, but also helps people to develop relationships with others. Some of the key aspects are:

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

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

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

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

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

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

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

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

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

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

2.5 WAREHOUSING

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

Even in our prehistoric times storage facilities were used for storing varied items. Clay jars were used for storing pickles, vegetables and wine. Since there were no refrigeration facilities, large food containers were used for preserving food either in oil or by sun drying. Buildings known as granaries were used for storing food crops such as wheat, bajra, barley etc. to protect them from mice and insects and were also used for storing animal feed.

2.5.1 IMPORTANCE OF WAREHOUSING

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

(a) Storage: Businessman stores goods in warehouses for different purposes:

- To maintain continuity in production, a good quantity of raw materials is to be kept in stock.

- In case the manufacturer anticipates a rise in prices of raw materials in future he/she likes to purchase it in advance and stock it.
- Since goods are generally produced in anticipation of demand, these need to be stored till sales take place.
- Similarly, some goods may be produced during a part of the year but used throughout the year like sugar.
- Wholesalers buy goods in bulk and maintain stock of goods in warehouses for sale in small quantities to retailers from time to time.

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

(c) Use for Importers: Warehouses (known as bonded warehouse) are used for storage of imported goods till the importer is able to pay the customs duty and take delivery. Based on the above uses of warehousing, it can be concluded that it is an important link in the chain of marketing and adds to the time and place value of goods. It also smoothens out fluctuations in their supply and demand. So, wherever there is trade and commerce, there is need for warehousing.

2.5.2 TYPES OF WAREHOUSES

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

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

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

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

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

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

2.5.3 FUNCTIONS OF WAREHOUSES

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

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

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

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

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

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

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

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

TERMINAL EXERCISE

Very Short Answer Questions

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

Short Answer Questions

1. Mention any two general utility services rendered by commercial banks.
2. Distinguish between whole-life policy and endowment policy.
3. State any two points of importance of transportation for business.
4. What is meant by post restante letter.
5. Explain any two functions of warehousing.
6. What is meant by cash credit?
7. What is meant by a Bank overdraft?
8. Give the full form of NSC.
9. What is meant by courier service?

Long Answer Questions

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

3.BUSINESS ENVIRONMENT

Once a business is established, to successfully run and sustain it requires finance for this it depends on financial institutions; accept the norms and culture in which it operates for this it depends on the society; understand the requirements of the market for this it depends on the customers; upgrade itself with the latest developments for which the latest technological aspects are required. Also, it needs to understand the government regulations and other legal aspects. Thus there are many factors and dimensions that affect the business. They are combined under a single concept referred to as business environment.

The business environment consists of the economic aspect, the socio-cultural aspects, the political framework, the legal aspects, the technological aspects etc. Understanding the environment within which the business has to operate is very important as it influences every aspect, be it its nature, its location, the prices of products, the distribution system, or the personnel policies. In this chapter, we shall learn about the concept of business environment, its nature and significance and the various components of the environment. In addition, we shall also acquaint ourselves with the concept of social responsibility of business and business ethics.

LEARNING OUTCOMES

- identifies various components of business environment and their likely impact on a business;
- discussies the changes in components of business environment for a business;
- describe vulnerability of business to changes in external environment.
- identifyes various economic and promotional activities undertaken by Government and their likely effect on business.
- discusses the various CSR initiatives by companies in real life.
- explains how business may become more environment friendly.
- reflects on making socially ethical responsible choices in business.

3.1 MEANING OF BUSINESS ENVIRONMENT

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

have a clear understanding of the concept of business environment and the nature of its various components.

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

3.1.1 FEATURES OF BUSINESS ENVIRONMENT

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

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

(b) **Micro and Macro factors:** It covers micro or specific factors that affect business directly such as investors, competitors, customers. Macro or general factors include social, political, cultural, legal, government and technological aspects.

(c) **Inter-relatedness:** All the micro and macro factors are inter-dependent and inter-related to one another.

(d) **Dynamic:**The business environment is dynamic in nature, that means, it keeps on changing.

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

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

3.1.2 IMPORTANCE OF BUSINESS ENVIRONMENT

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

(a) **Determining Opportunities and Threats:** The interaction between the business and its environment helps in identifying opportunities and threats to the business. It helps the business

enterprises for meeting the challenges successfully through future planning and decision making. For example, competition increases with the entry of new firms in the market.

(b) Giving Direction for Growth: The interaction with the environment leads to opening up new frontiers of growth for the business firms. It enables the business to identify the areas for growth and expansion of their activities. For example, seeing the potential of mobile phones growth Reliance launched the Jio.

(c) Continuous Learning: Environmental analysis makes the task of managers easier in dealing with business challenges. The managers are motivated to continuously update their knowledge, understanding and skills to meet the predictable changes in the realm of business. For example, the new mobile companies- Redmi and MI have expanded their market shares by adding new features to the android phones.

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

(e) Meeting Competition: It helps the firms to analyze the competitors' strategies and formulate their own strategies accordingly. For example, Pepsi and coke pricing strategy.

(f) Identifying Firm's Strength and Weakness: Business environment helps to identify the individual strengths and weaknesses in view of the technological and global developments. For example, development of all the latest gadgets.

3.2 TYPES OF BUSINESS ENVIRONMENT

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

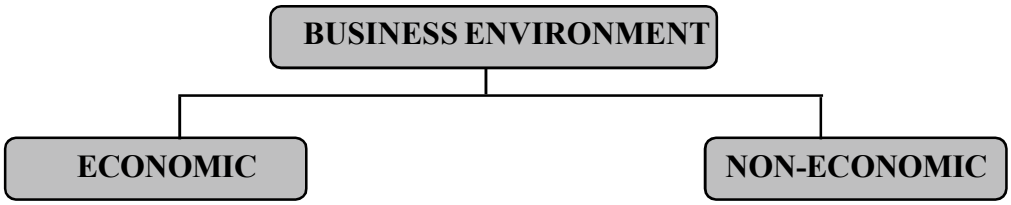


Fig.: 3.1

3.2.2 ECONOMIC ENVIRONMENT

Economic environment consists of type of economic system, nature and structure of the economy, foreign trade and foreign investment policies. The survival and success of each and every business

enterprise depends fully on its economic environment. The main factors that affect the economic environment are:

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

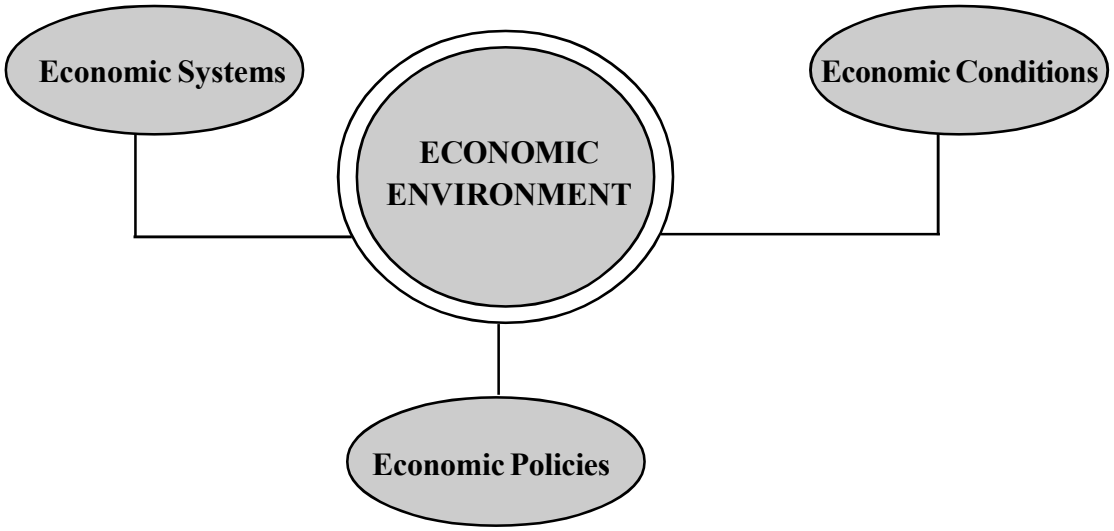


Fig.: 3.2

(b) Economic Policies: All business activities and operations are directly influenced by the economic policies framed by the government from time to time. Some of the important economic policies are: (i) Industrial policy (ii) Fiscal policy (iii) Monetary policy (iv) Foreign investment policy, and (v) Export-Import policy (Exim policy) The government keeps on changing these policies from time to time in view of the developments taking place in the economic scenario, political expediency and the changing requirement. Every business firm has to function strictly within the policy framework and respond to the changes therein.

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

Important Economic Policies

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

(ii) Fiscal policy: It includes government policy with reference to public expenditure, taxation and public debt.

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

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

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

3.2.2 NON ECONOMIC ENVIRONMENT

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

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

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

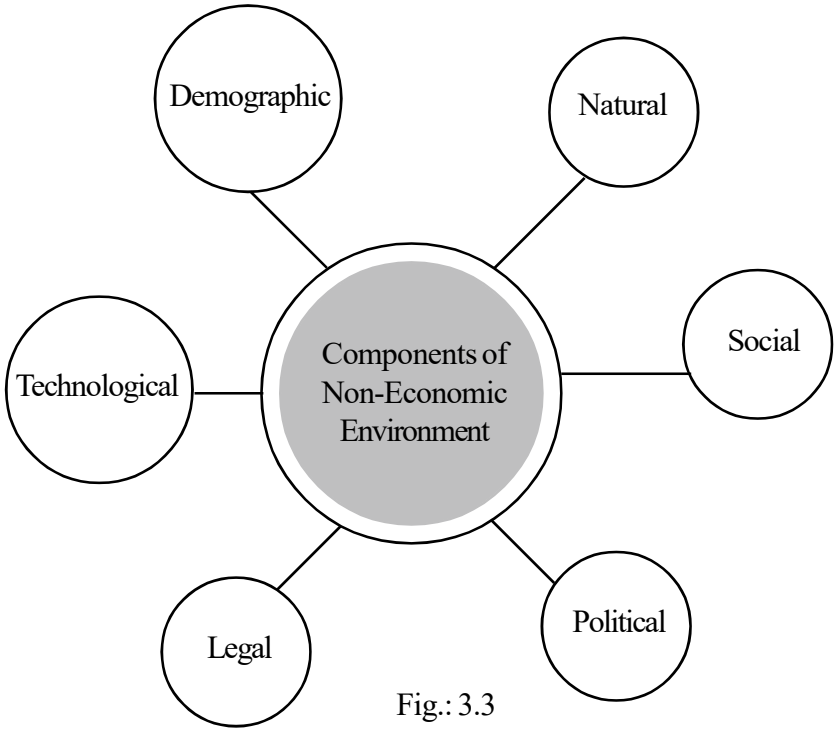


Fig.: 3.3

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

(i) Companies Act,2013 and Companies Act 1956

(ii) Foreign Exchange Management Act, 1999

(iii) The Factories Act, 1948

(iv) Industrial Disputes Act, 1947

(v) Payment of Gratuity Act, 1972

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

(vii) Prevention of Food Adulteration Act, 1954, repealed by. The food safety and standars Act, 2002

(viii) Essential Commodities Act, 2002

(ix) The Standards of Weights and Measures Act 1976 replead by the legal metrology Act, 2009 replaced by. The competition Act. 2002

(x) Monopolies and Restrictive Trade Practices Act, 1969

(xi) Trade Marks Act, 1999

(xii) Bureau of Indian Standards Act, 2016

(xiii) Consumer Protection Act, 2019

(xiv) Environment Protection 1986

(d) Technological Environment: Technological environment includes the methods, techniques and approaches adopted for production of goods and services and its distribution. The varying technological environments of different countries affect the designing of products. For example, in USA and many other countries electrical appliances are designed for 110 volts. But when these are made for India, they have to be of 220 volts. In the modern competitive age, the pace of technological changes is very fast. Internet, World Wide Web, android phones have brought about a technological revolution. Hence, in order to survive and grow in the market, a business has to adopt the technological changes from time to time. It may be noted that scientific research for improvement and innovation in products and services is a regular activity in most of the big industrial organisations.

(e) Demographic Environment: This refers to the size, density, distribution and growth rate of population. All these factors have a direct bearing on the demand for various goods and services. For example, a country where population rate is high and children constitute a large section of population, then there is more demand for baby products. Similarly the demand of the people of cities and towns are different than the people of rural areas. The high rise of population indicates the easy availability of labour. These encourage the business enterprises to use labour intensive techniques of production. Moreover, availability of skilled labour in certain areas motivates the firms to set up their units in such areas. For example, the business units from America, Canada, Australia, Germany, UK, are coming to India due to easy availability of skilled manpower. Thus, a firm that keeps a watch on the changes on the demographic front and reads them accurately will find opportunities knocking at its doorstep.

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

3.3 RECENT DEVELOPMENTS IN INDIAN ECONOMY

The economic environment of business in India has been changing at a fast rate mainly due to the changes in the economic policies of the government. At the time ofindependence, the Indian economy was basically agrarian with a weak industrial base.To speed up the industrial growth and solve various economic problems, the government took several steps like state ownership of certain categories of industries, economic planning, reduced role of private sector, etc. The Government adopted several control measures on the functioning of private sector enterprises. All these efforts resulted a mixed response. There was growth in net national product, per capita income and development of capital

goods sector and infrastructure. But rate of industrial growth was slow, inflation increased and government faced a serious foreign exchange crisis during the eighties. As a result, the government of India introduced a radical change in economic policies in 1991. These changes abolished industrial licensing in most of the cases, allowed private participation in most industries; disinvestment was carried out in many public sector industrial enterprises and opened up the economy considerably. Foreign Investment Promotion Board was set up to channelize foreign capital investment in India. Let us discuss the developments under three heads, viz.,

(a) Liberalisation, (b) Privatisation, and (c) Globalisation.

Fig.: 3.4

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

i. Abolishing industrial licensing requirements in most of the industries;

ii. Freedom in deciding the scale of business activities;

iii. Freedom in fixing prices of goods and services;

iv. Simplifying the procedure for imports and exports;

v. Reduction in tax rates; and

vi. Simplified policies to attract foreign capital and technology to India.

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

(b) Privatisation: Privatisation refers to reducing the role of public sector by involving the private sector in most activities. Due to the policy reforms announced in 1991, the expansion of

public sector has literally come to a halt and the private sector registered fast growth in the post-liberalisation period. The issues of privatisation include:

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

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

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

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

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

3.3.1 IMPACT OF GOVERNMENT POLICY CHANGES ON BUSINESS & INDUSTRY

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

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

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

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

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

3.3.2 GOODS AND SERVICE TAX (GST)

Keeping in view the theme of 'One nation and one tax', the government of India, implemented the Goods and Services Tax (GST) from July 1, 2017.It is an indirect taxlevied on the supply of goods and services and has replaced many indirect tax laws that previously existed in India.This tax, apart from being a source of revenue for growth, also plays a key role in making the State accountable to its taxpayers. Effective taxation ensures that public funds are effectively employed in fulfilling social objectives for sustainable development. GST provides for the following benefits to the business and economy:

1. eliminates tax on tax;

2. is technology driven with simple and online procedures;

3. has brought down the cost of goods and services;

4. speeds up the taxation procedures;

5. has tremendously reduced the number of compliances attached ;

6. unorganised sector can now be regularised .

3.3.2 MAKE IN INDIA

Make in India was launched by Government of India in September 2014 as part of the nation-building initiatives. Its sole purpose is to facilitate investment, encourage innovation, boost up skill development and invite various commercial sectors from all around the world to engineer their products in India and sell them anywhere they wish. This new national program is led by the Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry, Government of India. The Make in India aims at utilising the existing Indian talent base, creating additional employment opportunities and empowering secondary and tertiary sectors.

Fig.: 3.5

Source: commons. wikimedia.org.wiki/file:make in-india....jpg

The focus of Make in India programme is on 25 sectors. These include: automobiles,aviation, chemicals, IT & BPM, pharmaceuticals, construction, defence manufacturing, electrical machinery, food processing, textiles and garments, ports, leather, media and entertainment, wellness, mining, tourism and hospitality, railways, automobile components, renewable energy, biotechnology, space, thermal power, roads and highways, and electronics systems. The programme also aims at improving India's rank on the Ease of Doing Business by eliminating the unnecessary laws and regulations, making bureaucratic processes easier, making the government more transparent,responsive and accountable.

Aims and objectives of Make in India

i. Expansion of job opportunities;

ii. Ease of doing business;

iii. Upgradation of technology;

iv. Eliminating unnecessary laws and restrictions;

v. Improving India's ranking in the Global market;

vi. Making bureaucratic procedures easier;

vii. Making Government transparent, responsive and accountable;

viii. Boost up India's economic growth

3.3.3 DIGITAL INDIA

Another new campaign launched by Government of India in July 2015 aims in connecting rural areas with high speed internet connectivity and improve digital literacy. In order to make available Government's services to all citizens electronically, digital India was initiated by department of Electronics and information technology. A digitally empowered society can improve the economic and social aspects of its people by providing access to health, education, financial services, information and technology. Digital India consists of three core components:

(a) Creating digital infrastructure,

(b) delivering government services digitally and

(c) digital literacy.

Benefits of Digital India

i. Introduction of new services like e-education, e-health, e-sign, digi locker

ii. People empowerment;

iii. Easy access to information;

iv. improved quality of services;

v. Less documentation and formalities;

vi. Generation of employment in the IT sectors

vii. Boost to industry

3.4 SOCIAL RESPONSIBILITY OF BUSINESS

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

3.4.1 CONCEPT OF SOCIAL RESPONSIBILITY

Social responsibility of business means obligation to act in a manner which will serve the best interests of the society. Also known as corporate social responsibility (CSR)it refers to the organisations conducting their business ethically keeping their interest towards social, cultural, economic and environmental issues. Social obligation of a business is different from legal obligation. Legal obligation is observed because of the provisions or fear of law, but social obligation will help to take voluntary efforts on the part of business to fulfill the needs of the society. By fulfilling the social obligations, business creates an environment which is conducive to its success. The Government of India requires large companies to spend at least 2 % of their profits every year on CSR.

Social responsibility is important because of the following reasons:

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

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

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

4. **Social Awareness:** Now-a-days consumers are aware of the quality of various products, the market price of various products, the name of reputed companies supplying the product

etc. Therefore, they should be given fair treatment by the business. Otherwise, they will organise and form Consumer Associations. This will compel the business to perform social obligations.

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

6. **Moral Justification:** Every business organisation uses human resources, physical resources and capital of the society. Roadways, power and water supply are used by business firms. The products of business units are sold to the society.

3.4.2 RESPONSIBILITIES TOWARDS DIFFERENT INTEREST GROUPS

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

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

To sum up, responsibility towards owners or investors:

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

(b) Responsibility towards the Employees: A business enterprise must ensure afair wage or salary to the workers based on the nature of work involved and the prevailing rates in the market. The working conditions must be good in respect of safety, medical facilities, canteen, housing, leave and retirement benefits etc. They should also be paid reasonable amount of bonus based on the business earnings. Preferably, there should also be a provision for their participation in management as without employees no organisation can survive. The brain, efforts, talent and expertise of employees bring success to business concerns. The responsibility of business towards its employees are as follows:

1. To provide reasonable and fair wages and salaries.

2. To maintain good working conditions for the good health of the workers.

3. To provide services such as housing, medical care, recreation etc.

4. To develop a sense of belonging.

5. To win the co-operation of the workers by creating better human relations in the business.

(c) **Responsibility towards the Consumers:** A business enterprise must supply quality goods and services to the consumers at reasonable prices. It should avoid adulteration, poor packaging, misleading and dishonest advertising, andensure proper arrangement for attending to customer complaints and grievances. The products produced by the business are used by consumers. The responsibilities of business towards the consumers are as follows:

1. To ensure regular supply of goods/services.

2. To provide goods at reasonable prices.

3. To provide goods which will help to meet the needs of consumers of different classes.

4. To provide goods of standard quality.

5. To ensure that advertisements made are true.

6. To provide prompt and continuous service.

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

1. To abide by the laws of the nation.

2. To pay taxes honestly and on time.

3. To refrain from corrupting government employees.

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

5. To adapt fair dealings in foreign trade.

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

1. To protect the environment from pollution.
2. To provide better employment opportunities.
3. To preserve social and cultural values.
4. To help the weaker sections of the society like disabled persons, widows, scheduled tribes etc.
5. To promote national integration.

Looking at the importance of the social responsibilities of business towards various groups, it would have been better if the Companies Act provided for the reporting of the social activity in the annual report of the companies. However, a few large companies have been voluntarily reporting their social performances in their Annual Reports regularly. The prominent among them are Cement Corporation of India, Indian Oil Corporation, Tata Steels, Asian paints and ITC. These reports reveal that companies are becoming eco-friendly and conscious of their role in community development.

3.4.3 BUSINESS AND ENVIRONMENTAL PROTECTION

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

1. **Air Pollution:** Air pollution is the result of a combination of factors which decreases the air quality. Carbon monoxide emitted by automobiles mainly contributes to air pollution.
2. **Water Pollution:** Chemical waste from factories is polluting the water bodies of every country. Throwing of plastic bags filled with flowers and other materials lastic bottles etc. pollute our rivers, streams and lakes.
3. **Land Pollution:** Excessive usage of pesticides in agriculture has damaged ourdivine land. People go for shopping every day and have the habit of buying in plastic bags. People throw these plastic bags here and there, causing pollution of soil.
4. **Noise Pollution:** Running of factories is a source of noise pollution. Automobiles also cause noise pollution. Noise pollution may cause mental disorder, loss of hearing, malfunctioning of heart etc.

Need for Pollution Control

Pollution control is required because of the following reasons:

1. To reduce safety hazards and to ensure safety of life.

2. To reduce risk of liability to pay compensation to people

3. To protect public health.

4. To reduce health hazards like water pollution (which will affect fishes and otherwater plants), human health hazards such as breathing difficulty, irritation in eyes etc.

5. To save cost of cleaning the land and machines.

3.5 BUSINESS ETHICS

Business Ethics means the business practices which are desirable from the point of view of the society. i.e. the moral principles which should be followed by business. Business ethics are concerned with determining what is right and what is wrong while doing the business. By ethics we mean the business practices which are desirable from the point of view of the society.

A few examples of ethical business practices are:

1. To charge fair prices from the customer.

2. To use fair weights for commodities.

3. To pay taxes to government correctly and promptly.

4. To ensure supply of safe products for the public.

5. To give fair treatment to the workers.

6. Not to indulge in unfair trade practices, mal-practices, black marketing and hoarding.

3.5.1 ELEMENTS OF BUSINESS ETHICS

The elements of business ethics are as follows:

1. Business ethics create self-imposed discipline on the part of the business firms.

2. Business ethics make a business honest and responsible.

3. Business ethics aim at fair and reasonable treatment to customers, employees, suppliers etc.

4. Business ethics co-exist with law which will help in the perfection of the conduct of life.

5. Business ethics covers all business practices which are desirable from the point of view of the society.

TERMINAL EXERCISE

Very Short Answer Questions

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

Short Answer Questions

1. How does demographic environment of business influence the business activities.
2. What are the steps Government of India has taken as a part of its liberalisation process.
3. Explain the effect of political environment in the normal functioning of business enterprises.
4. Why should a business enterprise be socially responsible?
5. What are the effects of Globalisation of Indian economy?
6. Briefly explain the concept of social responsibility.
7. Enumerate the responsibilities of business towards its employees.
8. Give any four arguments in favour of social responsibility.
9. What do you mean by the term 'business ethics' ?

Long Answer Questions

1. Describe the importance of business environment for the business firm.
2. Explain any two non-economic features of business environment.

3. What is meant by social responsibility of business? State the responsibilities of business towards the community.

4. Describe in brief the economic environment of business.

5. Explain the social responsibility of business towards different groups.

6. What are the responsibilities of business towards investors, consumers and employees?

7. What do you mean by social responsibility? Explain some points favouring social responsibility of business.

8. What do you mean by business ethics? Give three examples. Which are the elements of business ethics? Explain briefly.

9. "Knowledge of Business Environment helps the businessmen to understand the opportunities for and threats to the business." In the light of this statement explain the importance of Business Environment that helps the Businessmen to prepare future plans.

10. "Business has to take into account the expectations of various stakeholders like the workers, the consumers, the Government and the community." Comment on this statement with an explanation of Social Responsibilities of business.

4. FORMS OF BUSINESS ORGANISATIONS

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

LEARNING OUTCOMES

- describes the basic features of different forms of business organisations; and
- distinguishes between different forms of business organisations.

4.1 MEANING OF BUSINESS ORGANISATION

You have already learnt about the meaning of business and the various types of business activities like industry, trade, transport, banking, insurance etc. If you observe these business activities carefully, you will realise that whatever business activity one may take up, he/she has to bring together various resources like men, money, materials, methods, machines, technology, etc. to carry out that activity successfully. In addition, these resources are to be put into action in a systematic manner to achieve the objectives of business.

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

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

4.2 FORMS OF BUSINESS ORGANISATION

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

company. Such arrangement of ownership and management is termed as a form of business organisation. A business organisation usually takes the following forms in India:

(1) Sole proprietorship

(2) Partnership

(3) Joint Hindu Family

(4) Cooperative Society

(5) Joint Stock Company

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

4.3 SOLE PROPRIETORSHIP

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

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

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

You must have seen many more such business organisations in and around your locality. Make a list of such concerns engaged in different types of businesses.

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

Definition of Sole Proprietorship:

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

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

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

4.3.1 CHARACTERISTICS OF SOLE PROPRIETORSHIP FORM OF BUSINESS ORGANISATION

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

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

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

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

(e) **No Sharing of Profit and Loss:** The sole proprietor enjoys the profits. At the same time, the entire loss is also borne by him. The profits and losses of the business are not shared by the proprietor. He alone bears the risks and reaps the profits.

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

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

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

4.3.2 MERITS OF SOLE PROPRIETORSHIP FORM OF BUSINESS ORGANISATION

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

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

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

(d) **Flexibility in Operation:** It is very easy to bring about changes as per the requirements of the business. The expansion or curtailment of business activities does not require many formalities as in the case of other forms of business organisation.

(e) **Maintenance of Business Secrets:** The business secrets are known only to the proprietor. He is not required to disclose any information to others unless and until he himself so decides. He is also not bound to publish his business accounts.

(f) **Personal Touch:** Since the proprietor himself handles everything relating to business, it is easy to maintain a good personal contact with the customers and employees. By knowing the likes, dislikes and tastes of the customers, the proprietor can adjust his operations accordingly. Similarly, as the employees are few and work directly under the proprietor, it helps in maintaining a harmonious relationship with them, and run the business smoothly.

Though sole proprietorship is a popular form of business organisation yet it suffers from various limitations, let us discuss.

4.3.3 LIMITATIONS OF SOLE PROPRIETORSHIP FORM OF BUSINESS ORGANISATION

(a) **Limited Resources:** The resources of a sole proprietor are always limited.Being the single owner it is not always possible to arrange sufficient funds fromhis own sources. Again borrowing funds from friends and relatives or from banks has its own implications. So, the proprietor has a limited capacity to raise funds for his business.

(b) **Lack of Continuity:** The continuity of the business is linked with the life of theproprietor. Illness, death or insolvency of the proprietor can lead to closure of the business. Thus, the continuity of business is uncertain.

(c) **Unlimited Liability:** You have already learnt that there is no separate existence of the sole proprietorship business from its owner. In the eyes of law the proprietor and the business are

one and the same. So personal properties of the owner can also be used to meet the business obligations and debts.

(d) **Limited Managerial Expertise:** A sole proprietorship form of business organisation always suffers from lack of managerial expertise. A single person may not be an expert in all fields like, purchasing, selling, financing etc. Again, because of limited financial resources, and the size of the business it is also not possible to engage professional managers in sole proprietorship form of business organisations.

(e) **Not Suitable for Large Scale Operations:** Since, the resources and the managerial ability is limited, sole proprietorship form of business organisation is not suitable for large-scale business.

4.3.4 SUITABILITY OF SOLE PROPRIETORSHIP FORM OF BUSINESS ORGANISATION

You have learnt about the meaning, characteristics, merits and limitations of sole proprietorship form of business organisations. After such a detailed study, it should now be easier for you to identify areas in which sole proprietorship form of business organisation is most suitable. To assist you in such exercise, it can be stated that the sole proprietorship is suitable where:

- The market is limited, localised and the customers give importance to personal attention.
- The capital requirement is small and risk involved is limited.
- The production of goods involves manual skills e.g., handicrafts, filigree work, jewellery, tailoring, haircutting etc.

4.4 PARTNERSHIP

A textile factory is going to be started in the nearby area where Gopal is carrying on his business. As a businessman, he is now in a jubilant mood. He is thinking that once the textile factory is set up, he will get more customers; the sales will increase and he will earn more profit. But, for all these, he will have to expand his business, and for this he needs more money. The major problem is how to arrange for additional funds. He has the option of getting a loan from the bank. But the fear of loss comes to his mind again and again. He does not want to take that risk. Another option is that he may join hands with some other person who is also keenly interested to join his business. By doing so, more resources can be raised, work can be shared, and business can run in a better way. The risk of loss will also be shared. But this involves a new form of business organisation known as Partnership organisation. To form partnership business,Gopal has to gain clarity on the exact nature of this form of business organisation, its pros and cons before he goes in for it. 'Partnership' is an association of two or more persons who not only pool their financial and managerial resources but also agree to carry on a business, and share its profits or losses.

Let's assume that Gopal joins hand with Rahim to start a big grocery shop. Here both Gopal and Rahim are called partners who are running the partnership firm jointly. Both of them will pool their

resources and carry on business by applying their expertise. They will share the profits and losses in the agreed ratio. In fact, for all terms and conditions of their working, they have to sit together to decide on all aspects. There must be an agreement between them. The agreement may be oral, written or implied. When the agreement is in writing it is termed as partnership deed. However, in the absence of an agreement, the provisions of the Indian Partnership Act 1932 shall apply.

Partnership form of business organisation in India is governed by the Indian Partnership Act, 1932, and section 4 of the Act defines partnership as "the relation between persons who have agreed to share the profits of the business, carried on by all or any of them, acting for all". Individually every person who joins the partnership is called a partner and collectively known as a firm.

4.4.1 CHARACTERISTICS OF PARTNERSHIP FORM OF BUSINESS ORGANISATION

Based on the definition of partnership as given above, the various characteristics of partnership form of business organisation, can be summarised as follows:

(a) Two or More Persons: To form a partnership firm atleast two persons are required. As per the Rule 10 of the Companies Act 2013, the maximum limit on the number of persons is 100.

(b) Contractual Relationship: Partnership is created by an agreement among the persons who have agreed to join hands. Such persons must be competent to contract. Thus, minors, lunatics and insolvent persons are not eligible to become partners. However, a minor can be admitted to the benefits of partnership firm i.e., he can have a share in the profits without any obligation for losses.

(c) Sharing Profits of Business: There must be an agreement among the partners to share the profits and losses of the business of the partnership firm. If two or more persons share the income of jointly owned property, it is not regarded as partnership.

(d) Existence of Lawful Business: The business of which the persons have agreed to share the profit must be lawful. Any agreement to indulge in smuggling, black marketing etc. cannot be called partnership business in the eyes of law.

(e) Principal Agent Relationship: There must be a mutual agency relationship between the partners. Every partner is the principal as well as the agent of the firm. When a partner deals with other parties he/she acts as an agent of other partners, and at the same time the other partners become the principal.

(f) Unlimited Liability: The partners of the firm have unlimited liability. They are jointly as well as individually liable for the debts and obligations of the firms. If the assets of the firm are insufficient to meet the firm's liabilities, the personal properties of the partners can also be utilised for this purpose. However, the liability of a minor partner is limited to the extent of his share in the profits.

(g) Voluntary Registration: The registration of partnership firm is not compulsory. But an unregistered firm suffers from some limitations which makes it virtually compulsory to be registered. Following are the limitations of an unregistered firm:

i. The firm cannot sue third party, although a third party can sue it.

ii. In case of any dispute among the partners, it is not possible to settle the dispute through court of law.

iii. The firm cannot claim adjustments for amount payable to, or receivable from, any other parties.

4.4.2 MERITS OF PARTNERSHIP FORM OF BUSINESS ORGANISATION

(a) Easy to Form: A partnership can be formed easily without many legal formalities. Since it is not compulsory to get the firm registered, a simple agreement, either in oral, writing or implied is sufficient to create a partnership firm.

(b) Availability of Larger Resources: Since two or more partners join hands to start partnership firm it may be possible to pool more resources as compared to sole proprietorship form of business organisation.

(c) Better Decisions: In partnership firm each partner has a right to take part in the management of the business. All major decisions are taken in consultation with and with the consent of all partners. Thus, collective wisdom prevails and there is less scope for reckless and hasty decisions.

(d) Flexibility: The partnership firm is a flexible organisation. At any time the partners can decide to change the size or nature of business or area of its operation after taking the necessary consent of all the partners.

(e) Sharing of Risks: The losses of the firm are shared by all the partners as per the agreed ratio.

(f) Keen Interest: Since partners share the profit and bear the losses, they take keen interest in the affairs of the business.

(g) Benefits of Specialisation: All partners actively participate in the business as per their specialisation and knowledge. In a partnership firm providing legal consultancy to people, one partner may deal with civil cases, one in criminal cases, another in labour cases and so on as per their area of specialisation.

(h) Protection of Interest: In partnership form of business organisation, the rights of each partner and his/her interests are fully protected. If a partner is dissatisfied with any decision, he can ask for dissolution of the firm or can withdraw from the partnership.

(i) **Secrecy:** Business secrets of the firm are only known to the partners. It is notrequired to disclose any information to the outsiders. It is also not mandatory to publish the annual accounts of the firm.

(j) **Tax advantage:** The share of profits in the firm is exempt from tax in the hands of partners. If there is a registered partnership deed, the firm can take the benefits of reducing tax liability under the provisions of Income-Tax Act1961. Having learnt about the nature and merits of the partnership form of business organisation, now Gopal has decided to expand his business by starting a partnership form of business. One day, in a happy mood, he met Rahim (who also runs a grocery shop in the same locality) and explained to him about the concept, characteristics and merits of partnership form of business organisation. Rahim heard Gopal very carefully and asked Gopal about the limitations (if any) of this form of business organisation. Gopal had no idea about any limitations. Gopal also observed that Rahim looked hesitant. Let him now have an idea about the limitations of partnership form of business organisation and also know what are the various types of partners that can be admitted.

4.4.3 LIMITATIONS OF PARTNERSHIP FORM OF BUSINESS ORGANISATION

A partnership firm also suffers from certain limitations. These are as follows:

(a) **Unlimited Liability:** The liability of the partners is unlimited i.e., the partners are personally liable for the debt and obligations of the firm. In other words, their personal property can also be utilised for payment of firm's liabilities incase the firm's assets are insufficient to pay debts.

(b) **Instability:** Every partnership firm has an uncertain life. The death, insolvency, incapacity or the retirement of any partner brings the firm to an end. Not only that, any dissenting partner can give notice at any time for dissolution of partnership.

(c) **Limited Capital:** Since the total number of partners cannot exceed 100, the capacity to raise funds remains limited as compared to a joint stock company where there is no limit on the number of share holders.

(d) **Non-transferability of share:** The share of interest of any partner cannot be transferred to other partners or to the outsiders. So it creates inconvenience for the partner who wants to transfer his share to others fully or partly. The only alternative is dissolution of the firm.

(e) **Possibility of Conflicts:** In partnership firm every partner has an equal right to participate in the management. Also, every partner can place his or her opinion or viewpoint before the management regarding any matter at any time. Because of this, sometimes there is friction and conflict among the partners. Difference of opinion may give rise to conflicts and lead to dissolution of the firm.

4.4.4 TYPES OF PARTNERS AND PARTNERSHIP

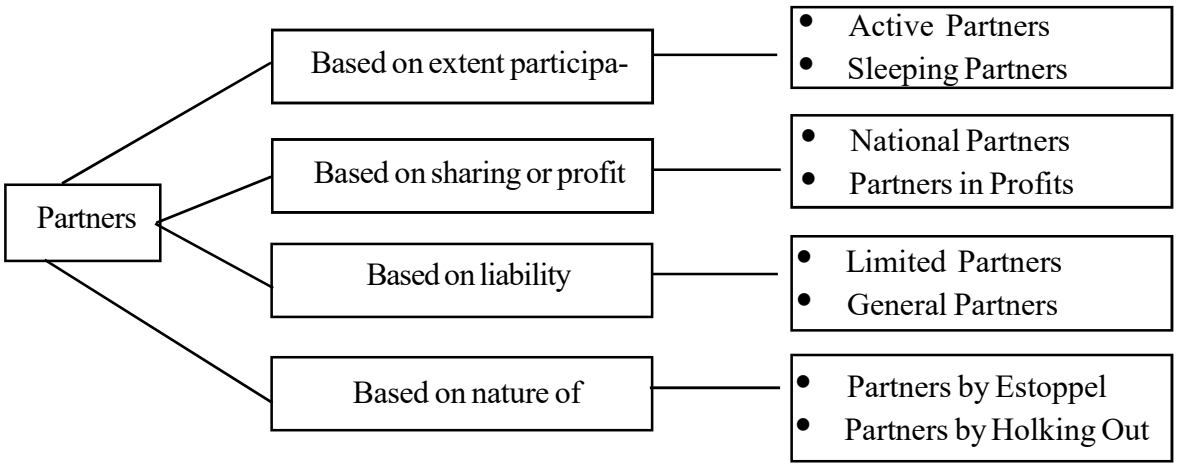


Fig.: 4.1

Types of Partners

You have learnt that generally every partner in a firm contributes to its capital, participates in the day-to-day management of firm's activities, and shares its profits and losses in the agreed ratio. In other words all partners are supposed to be active partners.However, in certain cases there are partners who play a limited role. They may contribute capital and such partners cannot be termed as active partners. Similarly, some persons may simply lend their name to the firm and make no contribution to capital of the firm. Such persons are partners only in name. Thus, depending on the extent of participation and the sharing of profits, liability etc., partners can be classified into various categories. These are summarised as under.

(A) Based on the extent of participation in the day-to-day management of the firm, partners can be classified as:

a. 'Active Partners': The partners who actively participate in the day-today operations of the business are known as active partners or working partners.

b. 'Sleeping Partners': Those partners who do not participate in the day to- day activities of the business are known as sleeping or dormant partners. Such partners simply contribute capital and share the profits and losses.

(B) Based on sharing of profits, the partners may be classified as:

a. 'Nominal Partners': Nominal partners allow the firm to use their name as partner. They neither invest any capital nor participate in the day-today operations. They are not entitled to share the profits of the firm. However, they are liable to third parties for all the acts of the firm.

b. 'Partners in Profits': A person who shares the profits of the business without being liable for the losses is known as 'partner in profits'. This is applicable only to the minors who are admitted to the benefits of the firm and their liability is limited to their capital contribution.

(C) Based on Liability, the partners can be classified as:

a. 'Limited Partners': The liability of limited partners is limited to the extent of their capital contribution. This type of partners are found in Limited Partnership firms in some European countries and the USA.

b. 'General Partners': The partners having unlimited liability are called 'general partners' or Partners with unlimited liability. It may be noted that every partner who is not a limited partner is treated as a general partner.

(D) Based on the behaviour and conduct exhibited, there are two more types of partners besides the ones discussed above.

a. Partner by Estoppel: A person, who by his/her conduct or behaviour in the public gives an impression that he/she is a partner of the firm, is called 'partner by estoppel'. Such partners are not entitled to share the profits of the firm, but are fully liable if somebody suffers because of their false representation.

b. Partner by Holding out: Similarly, if a partner or partnership firm declares that a particular person is a partner of their firm, and such a person does not disclaim it, then he/she is known as 'Partner by Holding out'. Such partners are not entitled to profits but are fully liable as regards the firm's debts.

Types of Partnership

Partnership can be categorised as under:

1. **General and Limited Partnership:** In the general partnership, the liability of the partners is unlimited, whereas limited partnership has two types of partners: General Partner and Special Partner. Liability of general partner is unlimited whereas liability of special partner is limited. There should be at least one general partner in the limited partnership firm.

2. **Partnership at Will and Particular Partnership:** Partnership at will can be formed to run the business for an indefinite period, while particular partnership can be formed for some specific purpose or duration and it ends with the attainment of pre-determined specific purpose or time period.

3. **Legal and Illegal Partnership :** Although it is not essential to get the partnership registered under Indian Partnership Act, 1932 in order to bring it into existence, yet the partnership organisations have to work in accordance with the provisions of the Indian Partnership Act, 1932 . Those partnerships which work according to the provisions of the Indian Partnership Act, 1932 are considered as legal and those which do not work according to the provisions of the above mentioned Act are called illegal partnerships.

One of Gopal's friends Rahul comes to his shop and sits there for hours together. In Gopal's absence, he attends to the customers and deals with his suppliers. Under the impression that Rahul is a partner

(although he is not), a supplier finalised a deal which Gopal does not accept. In the process, the supplier suffers some loss. Can he claim the compensation from Rahul? What type of partner Rahul is?

4.4.5 SUITABILITY OF PARTNERSHIP FORM OF BUSINESS ORGANISATION

We have already learnt that persons having different ability, skill or expertise can join hands to form a partnership firm to carry on the business. Business activities like construction, providing legal services, medical services etc. can be successfully run under this form of business organisation. It is also considered suitable whereas capital requirement is of a medium size. Thus, business like a wholesale trade, professional services, mercantile houses and small manufacturing units can be successfully run by partnership firms.

4.4.6 PARTNERSHIP DEED

A partnership deed, also known as partnership agreement, is a written document that outlines in detail the rights and responsibilities of all partners in a business operation. For lasting relationship among partners, there must be a written agreement among the partners to carry out the business and share the profits and losses.

The deed must be in writing, duly signed by all the partners properly stamped except a minor who has been admitted to the benefits of partnership and properly stamped to take the benefits of tax. The agreement, i.e., the partnership deed must contain the following:

(i) The name of the firm

(ii) The nature of the business

(iii) The names and addresses of the partners

(iv) Location of business

(v) The term or duration of partnership, if decided

(vi) The amount of capital to be contributed by each partner

(vii) The ratio in which the profits and losses are to be shared among the partners

(viii) Rights and duties of partners.

(ix) Remuneration to partners and the timing and amount of withdrawals of cash by the partners

(x) The interest to be allowed on capital and charge on drawings.

(xi) Treatment of goodwill.

(xii) Preparation of accounts and their auditing.

(xiii) Procedure for dissolution of the firm etc.

(xiv) Procedure for settlement of disputes

(xv) Arbitration clause.

4.4.7 RULES APPLICABLE IN THE ABSENCE OF AN AGREEMENT

Often, you find that two or more friends having very good relations and utmost good faith voluntarily agree to run a business without any written agreement. Over the years when business starts earning huge profit or incurs substantial loss, then dispute arises regarding its sharing impacting good relations resulting in dissolution of partnership firm. Then what will you do to settle the dispute in the absence of any written agreement. Hence, you must be aware of the provisions and rules applicable in the absence of partnership deed to settle the dispute These are as follows:

(a) Profit or losses of the firm will be shared equally by the partners.

(b) Interest on capital will not be allowed to any partner. (If agreed, the interest will be allowed only out of available profits of the firm. In case of losses no interest will be allowed.)

(c) No interest will be charged on withdrawals made by the partners.

(d) Partners will be allowed an interest @6% on the loan given to the firm.

(e) No salary or remuneration will be allowed to any of the partner.

(f) Every partner must take part in the management of the business.

Hence, the partners should get their firm registered with the Registrar of Firms of the concerned state. Although registration is not compulsory, but to avoid the consequences of non-registration, it is advisable to get it registered when it is setup or at any time during its existence to avail the benefits of tax.

The procedure for registration of a firm is as follows.

a. The firm will have to apply to the Registrar of Firms of the concerned state in the prescribed form.

b. The duly filled in form must be signed by all the partners.

c. The filled in form along with prescribed registration fee must be deposited in the office of the Registrar of Firms.

d. The Registrar will scrutinise the application, and if then are satisfied that all formalities relating to registration have been duly complied with, they will put the name of the firm in his register and issue the Certificate of Registration.

Gopal is now running the partnership firm along with Rahim as a partner.They are earning good profit and managing their business smoothly. Gopal's father also runs a wholesale business in the same locality. That business was earlier being managed by Gopal's grandfather. One-day Gopal's father

revealed that Gopal and his younger brother and sister have an equal share in his wholesale business. It is a family business and Gopal can continue his own partnership business without losing his position in this family business. Gopal was confused. His father explained to him that under Hindu Law it is a Joint Hindu Family business. Let us know in detail about Joint Hindu Family form of business organisation.

After knowing about sole proprietorship and partnership forms of business organisation let us now discuss about a unique form of business organisation that prevails only in India and that too among the Hindus. The Joint Hindu Family (JHF) business is a form of ancestral business organisation run by Hindu Undivided Family (HUF) where the family members of three successive generations own the business jointly. The head of the family is known as Karta who manages the business. The other members are called co-parceners and all of them have equal ownership right over the properties of the business. It is to be noted here that if any income has been earned by any member of the joint Hindu Family because of his personal skills or traits, then such income will not be treated as income of HUF.

The membership of the JHF is acquired by virtue of birth in the same family. There is no restriction for minors to become the members of the business

4.5.1 CHARACTERISTICS OF JHF FORM OF BUSINESS ORGANISATION

From the above discussion, it must have been clear to you that the Joint Hindu family business has certain special characteristics which are as follows:

(a) **Formation:** In JHF business there must be at least two members in the family, and family should have some ancestral property. It is not created by an agreement. No legal formalities are required for its establishment. But it has to be registered with the Income tax department to avail the tax concessions involved.

(b) **Legal Status:** The JHF business is a jointly owned business. It is governed by the Hindu Succession Act 1956*

(c) **Membership:** In JHF business outsiders are not allowed to become the coparcener. Only the members of undivided family acquire co-parcenership rights by birth.

(d) **Profit Sharing:** All co-parceners have equal share in the profits of the business.

(e) **Management:** The business is managed by the senior most member of the family known as Karta. Other members do not have the right to participate in *The Hindu Succession (Amedment) Act, 2005 the management. The Karta has the authority to manage the business as per his own will and his ways of managing cannot be questioned. If the co-parceners are not satisfied, the only remedy is to get the HUF status of the family dissolved by mutual agreement.

(f) **Liability:** The liability of co-parceners is limited to the extent of their share in the business. But the Karta has an unlimited liability. His personal property can also be utilised to meet the business liability.

(g) Continuity: Death of any co-parceners does not affect the continuity of business.Even on the death of the Karta, it continues to exist as the eldest of the co-parceners takes position of Karta. However, JHF business can be dissolved either through mutual agreement or by partition suit in the court.

4.5.2 MERITS OF JHF FORM OF BUSINESS ORGANISATION

Since Joint Hindu Family business has certain peculiar features as discussed above, it has the following merits.

(a) Assured Shares in Profits: Every co-parcener is assured of an equal share in the profits irrespective of his participation in the running of the business. This safeguards the interest of the minor, sick and physically and mentally challenged co-parceners.

(b) Quick Decision: The Karta enjoys full freedom in managing the business. It enables him to take quick decisions without any interference.

(c) Sharing of Knowledge and Experience: A JHF business provides opportunity for the young members of the family to get the benefits of knowledge and experience of the elder members. It also helps in inculcating virtues like discipline,self-sacrifice, tolerance etc.

(d) Limited Liability of Members: The liability of the co-parceners except the Karta is limited to the extent of their share in the business. This enables the members to run the business freely just by following the instructions or direction of the Karta.

(e) Unlimited Liability of the Karta: Because of the unlimited liability of the Karta, his personal properties are at stake in case the business fails to pay the creditors. This clause of JHF business enables the Karta to manage business most carefully and efficiently.

(f) Continued Existence: The death or insolvency of any member does not affect the continuity of the business. So it can continue for a long period of time.

(g) Tax Benefits: HUF is regarded as an independent assessee for tax purposes.The share of co-parceners is not to be included in their individual income for tax purposes.

After knowing the merits let us see the limitations of Joint Hindu Family as form of business organisation.

4.5.3 LIMITATION OF JHF FORM OF BUSINESS ORGANISATION

(a) Limited Resources: JHF business has generally limited financial and managerial resources. Therefore, it is not considered suitable for large business.

(b) Lack of Motivation: The co-parceners get equal share in the profits of the business irrespective of their participation. So generally, they are not motivated to put in their best.

(c) Scope for Misuse of Power: Since the Karta has absolute freedom to manage the business, there is scope for him to misuse it for his personal gains. Moreover, he may have his own limitations.

(d) Instability: The continuity of JHF business is always under threat. A small rift within the family may lead to seeking partition.

4.5.4 SUITABILITY OF JHF FORM OF BUSINESS ORGANISATION

The Joint Hindu Family form of business organisation is suitable where the family inherits a running business and the members of the family want to continue that business jointly as a family business. Even otherwise, this form of business organisation is considered suitable for a business that requires limited financial and managerial resources and having a very limited area of operation. It is found that JHF are usually engaged in trading business, indigenous banking, small industry, and crafts etc.

4.6 COOPERATIVE SOCIETY

You have learnt about Sole Proprietorship and Partnership as different forms of business organisation. You must have noticed that while there are many differences among the min respect of their formation, operation, capital contribution and liabilities. There is one similarity that both are engaged in business to earn profit. However, there are certain organisations which undertake business activities with the prime objective of providing service to the members. Although they also earn some amount of profit, but their main intention is to look after some common interest of its members. They pool available resources from the members, utilise the same in the best possible manner and share the benefits. These organisations are known as Co-operative Societies. Let us learn in detail about this form of business organisation.

The Section 4 of the Indian Cooperative Societies Act 1912 defines Cooperative Society as "a society, which has its objectives for the promotion of economic interests of its members in accordance with cooperative principles."

The term cooperation is derived from the Latin word 'co-operari', where the word 'Co' means 'with' and 'operari' mean 'to work'. Thus, the term cooperation means working together. So those who want to work together with some common economic objectives can form a society, which is termed as a cooperative society.

It is a voluntary association of persons who work together to promote their economic interest. It works on the principle of self-help and mutual help. The primary objective is to provide support to the members. People come forward as a group, pool their individual resources, utilise them in the best possible manner and derive some common benefits out of it.

4.6.1 CHARACTERISTICS OF COOPERATIVE SOCIETY

Based on the above definition we can identify the following characteristics of cooperative society as form of business organisation:

(a) **Voluntary Association:** Members join the cooperative society voluntarily i.e.by their own choice. Persons having common economic objective can join the society as and when they like, continue as long as they like and leave the society as and when they want.

(b) **Open Membership:** The membership is open to all those having a common economic interest. Any person can become a member irrespective of his/her caste, creed, religion, colour, sex etc.

(c) **Number of Members:** A minimum of 10 members are required to form a cooperative society. In case of multi-state cooperative societies the minimum number of members should be 50 from each state in case the members are individuals. The Cooperative Society Act does not specify the maximum number of members for any cooperative society. However, after the formation of the society, the members may specify the maximum member of members.

(d) **Registration of the Society:** In India, cooperative societies are registered under the Co-operative Societies Act 1912 or under the State Cooperative Societies Act. The Multi-state Cooperative Societies are registered under the Multi-state Cooperative Societies Act 2002. Once registered, the society becomes a separate legal entity and attains certain characteristics. These are as follows:

(i) It enjoys perpetual succession

(ii) It has its own common seal

(iii) It can enter into agreements with others

(iv) It can sue others in a court of law

(v) It can own properties in its name

(e) **State Control:** Since registration of cooperative societies is compulsory, every cooperative society comes under the control and supervision of the government. The cooperative department keeps a watch on the functioning of the societies. Every society has to get its accounts audited from the cooperative department of the government.

(f) **Capital:** The capital of the cooperative society is contributed by its members. Since, the members contribution is very limited, it often depends on loan from the government and apex cooperative institutions or by way of grants and assistance from state and central government.

(g) **Democratic Set Up:** The cooperative societies are managed in a democratic manner. Every member has a right to take part in the management of the society. However, the society elects a managing committee for its effective management. The members of the managing committee are elected on the basis of one-man one-vote irrespective of the number of shares held by any member. It is the general body of the society which lays down the broad framework within which the managing committee functions.

(h) Service Motive: The primary objective of all cooperative societies is to provide services to its members.

(i) Return on Capital Investment: The members get return on their capital investment in the form of dividend.

(j) Distribution of Surplus: After giving a limited dividend to the members of the society, the surplus profit is distributed in the form of bonus, keeping aside a certain percentage as reserve and for general welfare of the society.

4.6.2 TYPES OF COOPERATIVE SOCIETIES

You know co-operative organisations are set up in different fields to promote the economic well-being of different sections of the society. So, according to the needs of the people, we find different types of cooperative societies in India. Some of the important types are given below.

(a) Consumers' Cooperative Societies: These societies are formed to protect the interest of consumers by making available consumer goods of high quality at reasonable prices.

(b) Producer's Cooperative Societies: These societies are formed to protect the interest of small producers and artisans by making available items of their need for production, such as raw materials, tools, equipment etc.

(c) Marketing Cooperative Societies: To solve the problem of marketing the products, small producers join hands to form marketing co-operative societies.

(d) Housing Cooperative Societies: To provide residential houses to the members,housing cooperative societies are formed generally in urban areas.

(e) Farming Cooperative Societies: These societies are formed by the small farmers to get the benefits of large-scale farming.

(f) Credit Cooperative Societies: These societies are started by persons who are in need of credit. Credit Cooperative Societies accept deposits from the members and grant them loans at a reasonable rate of interest.

4.6.3 MERITS OF COOPERATIVE SOCIETY

The cooperative society is the only form of business organisation which gives utmost importance to its members rather than maximising its own profits. After studying its Characteristics and different types, we may now study the merits of this form of business organisation.

(a) Easy to Form: Any ten adult members can voluntarily form an association and get it registered with the Registrar of Cooperative Societies. The registration is very simple and it does not require much legal formalities.

(b) Limited Liability: The liability of the members of the cooperative societies is limited upto their capital contribution. They are not personally liable for the debt of the society.

(c) **Open Membership:** Any competent like-minded person can join the cooperative society any time he likes. There is no restriction on the grounds of caste, creed, gender, colour etc. The time of entry and exit is also generally kept open.

(d) **State Assistance:** The need for country's growth has necessitated the growth of the economic status of the weaker sections. Therefore, cooperative societies always get assistance in the forms of loans, grants, subsidies etc. from the state as well as Central Government.

(e) **Stable Life:** The cooperative society enjoys the benefit of perpetual succession.The death, resignation, insolvency of any member does not affect the existence of the society because of its separate legal status.

(f) **Tax Concession:** To encourage people to form cooperative societies, the government generally provides tax concessions and exemptions which keep on hanging from time to time.

(g) **Democratic Management:** The cooperative societies are managed by the Managing Committee, which is elected by the members. The members decide their own rules and regulations within the limits set by the law.

4.6.4 LIMITATIONS OF COOPERATIVE SOCIETY

Although the basic aim of forming a cooperative society is to develop a system ofmutual help and cooperation among its members, yet the feeling of cooperation does not remain for long. Cooperative societies usually suffer from the following limitations:

(a) **Limited Capital:** Most of the cooperative societies suffer from lack of capital.Since the members of the society come from a limited area or class and usually have limited means, it is not possible to collect huge capital from them. Again, government's assistance is often inadequate for them.

(b) **Lack of Managerial Expertise:** The Managing Committee of a cooperative society is not always able to manage the society in an effective and efficient way due to lack of managerial expertise. Again, due to lack of funds they are also not able to derive the benefits of professional management.

(c) **Less Motivation:** Since the rate of return on capital investment is less, the members do not always feel involved in the affairs of the society.

(d) **Lack of Interest:** Once the first wave of enthusiasm to start and run the business is exhausted, intrigue and factionalism arise among members quite frequently.This makes the cooperative lifeless and inactive.

(e) **Corruption:** In spite of government's regulation and periodical audit of the accounts of the cooperative society, the corrupt practices in the management cannot be completely ignored.

4.6.5 SUITABILITY OF COOPERATIVE SOCIETY

You have already learnt that cooperative society form of business organisations is a voluntary association of persons who are not financially to start and run the business individually. So to solve this problem or to meet the common requirements, this form of business organisation is most suitable. Thus, people can join hands to get the consumer products, to build residential houses, for marketing the products, to provide loans and advances etc. This form of business organisation is generally suitable for small and medium-sized business operation.

TERMINAL EXERCISE

Very Short Answer Questions

1. Define sole proprietorship.
2. List any two situations in which sole proprietorship form of business organisation is found to be most suitable
3. Who is a partner by estoppel?
4. Distinguish between partnership and sole proprietorship business on the basis of membership.
5. State the meaning of the term 'Coparcener'.

Short Answer Questions

6. State the suitability of sole proprietorship form of business organisation.
7. Explain any two limitations of partnership form of business organisation.
8. What is meant by 'partnership deed'? Is it essential for partnership?
9. Compare the status of a minor in partnership firm with that in a Joint Hindu Family business.
10. Mention any four characteristics a cooperative society attains after getting the registration certificate.

Long Answer Questions

11. Describe any four different types of partners.
12. What is a Joint Hindu Family business? Describe its main characteristics.
13. Explain the various merits of a Joint Hindu Family form of business organisation.
14. Give the definition of cooperative society as per the Indian Cooperative Societies Act.1912.
15. State any two characteristics of cooperative society form of business organisation.
16. State the different types of cooperative societies that exist in India.
17. There is a saying that it is always better to have a written agrement. Keeping in view this saying it is always advisable for partners to have a written agreement. What is the name of this agreement and what are its contents in general?
18. You have gone through the various forms of business organisations. If you get an opportunity to start a business in the present scenerio which form of business organisation will you choose & why? Express your views with valid points.

5. COMPANY FORM OF BUSINESS ORGANISATION

You must be aware that during the second five-year plan period five steel plants were established in India's underdeveloped areas to give a boost to the industrialization of the country. Do you know who owns these steel plants? It is the Government of India. It has set up a Joint Stock Company known as Steel Authority of India Limited (SAIL) for this purpose. You must have also heard the names of State Bank of India (SBI), National Thermal Power Corporation (NTPC), Grasim Industries Limited (GIL), Reliance Industries Limited (RIL) and Tata Steel Limited. These are all big business units and organised in the form of Joint Stock Companies. In this lesson we shall learn in detail about the Joint Stock Company; its merits and limitations; and also discuss the factors that influence the choice of form of business organisation.

LEARNING OUTCOMES

- discusses government's role in promoting planned economic development;
- describes the objectives of public and private sector enterprises.

5.1 JOINT STOCK COMPANY

In the previous lesson, you learnt in detail about four different forms of business organisation viz., Sole Proprietorship, Partnership, Joint Hindu Family Business and Cooperative Society. You know that these forms are considered suitable for small and medium sized business.

You are now very much aware about the limitations of partnership form of business like unlimited liability of partner, limited resources of arranging funds and restrictions on number of partners, so you can't think to set-up a capital intensive industry like Iron & Steel industry in partnership because it requires huge amounts of investments in capital assets and also for the operations of the business, which can't be financed by limited number of partners and all other limited sources.

You also know that society have very small savings and even if it is large amount in totality of savings it has no productive use. The amount of Small saver is very meager and they can't participate in partnership firm in which a significant amount of investment is needed. Hence, to mobilize the small savings of the society, the company form of business came into existence in which small savers can be shareholders by investing their savings, say even by investing of Rs. 1000 only (since the face value of one share is Rs10, he can purchase 100 shares and become the owner). In this way, to set-up an Iron and Steel Industry, Joint Stock Company may be the obvious choice where you can arrange large amount of capital from the members of the society whether they are small saver or huge amount savers.

A Joint Stock Company or simply a company is a voluntary association of persons, with a large and fluctuating membership, requires a more elaborate organisation, which ideally should confer corporate personality on the association, that is, should recognize that it constitutes a distinct legal position, subject to legal duties and legal rights separate from those of its members. This form of organization can be obtained easily and cheaply by registering an association as a company under the Companies Act 2013

after complying with some legal formalities. In India, the joint stock companies are governed by the Companies Act, 2013.

Meaning and definition of Company : Section 2 (20) of the Companies Act 2013 defines a "Company" as a company incorporated under this Act or under any previous company law. This definition does not clearly point out the meaning of a company. To understand the meaning of a company, let us see the following well known definition given by Prof. L.H. Haney as "an artificial person created by law, having separate entity, with a perpetual succession and common seal."

5.2 CHARACTERISTIC FEATURES OF A COMPANY

The salient features of a company are discussed below:

(a) Incorporated association: A company must be incorporated under the Companies Act. The minimum number of members required for this purpose is seven in the case of a 'public company' and two in the case of a 'private company'. Section 3 of the Companies Act allows formation of 'One Person Company' also.

(b) Legal entity distinct from its members: Unlike partnership, the company is distinct from its members. Hence, it is capable of enjoying rights and of being subjected to duties which are not the same as those enjoyed or borne by its members. A company can own property and deal with it the way it pleases. No member can either individually or jointly claim any ownership rights in the assets of the company during its existence or on its winding-up. A company, as a person separate is from its members and may even sue its own members for libel.

(c) Artificial Person: The company though a juristic person, does not possess the body of a natural being. It exists only in contemplation of law. Being an artificial person, it has to depend upon natural persons, namely, the directors, officers, shareholders etc., for getting its various jobs done. However, these individuals only represent the company and accordingly whatever they do within the scope of the authority conferred upon them and in the name and on behalf of the company, they bind the company and not themselves.

(d) Perpetual Succession: Company being an artificial person cannot be incapacitated by illness and it does not have an allotted span of life. Members may come and go but the company can go on forever. If continues even if all its human members are dead, insolvent or have left the membership.

(e) Common Seal: A company being an artificial person is not bestowed with a body of a natural being. Therefore, it does not have a mind or limbs of a human being. It has to work through the agency of human beings, namely, directors and officers and employees. Hence, all agreement executed on behalf of company should bear the seal of the company whether agreement is valid or not would depend upon facts of each case. The common seal is a seal used by a corporation as the symbol of its incorporation.

(f) Limited Liability: The members of the company are only liable to contribute towards payment of its debts to a limited extent. If the company is limited by shares, the shareholder's liability to

contribute is measured by the nominal value of the shares he holds plus any premium agreed on when the shares were issued. In case of companies limited by guarantee, the liability of each member shall be determined by the guarantee amount. If the guarantee company also has share capital, the liability of each member shall be determined in terms of not only the amount guaranteed but also the amount remaining unpaid on the shares held by member. A company may be formed with unlimited liability of members, thus the members shall continue to be liable till each paisa has been paid off.

(g) Transferability of Shares: One of the reasons for the popularity of public company has been that their shares are capable of being easily transferred without any consent of other members if the share of company is listed in any Stock Exchange. However, the article of association of a private company puts restrictions on transferability of its shares.

(i) Distinct pattern of management: You know that people from different walks of life and areas subscribe to the company by purchasing its shares. So, it is not possible for them to look after the day-to-day control and management of the company. The company law provides for the management of companies through the elected representatives of the members known as directors or board of directors.

5.3 KINDS OF COMPANIES

The companies Act provides for a variety of companies that may be promoted and registered under the Act. Let us discuss two common types of companies which are:

1. Private Companies:

(i) One person Company

(ii) Small Company

2. Public Companies

(1) Private Company

As per section 2 (68)," Private company" means a company having a minimum paid-up share capital of one lakh rupees or such paid-up capital as may be prescribed, and which by its articles,

(a) Restricts the right to transfer its share, if any;

(b) limits the number of its members to 200, not including

(i) Persons who are in the employment of the company; and

(ii) Persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, and where two or more persons hold one or more shares in a company jointly, they shall for the purposes of membership, be treated as a single member.

(c) Prohibits invitation to the public to subscribe for any securities of the company.

Ownership of these companies is confined only to well-known selected persons. It requires minimum of two persons to start a private limited company and write the word "Private Limited" at the end of its name. Usually, whenever partnership firms are in need of more money to expand their business, they convert themselves into private Companies. It may be noted that private companies are exempted from various regulations of the Companies Act.

Private companies may be of following two types:

(i) One Person Company: Section 3(1)(c) of the Companies Act 2013 defines, 'One Person Company' as "a company with only one person as its member." In other words, one person company can be formed if a private company by subscribing his name to a memorandum and complying with the requirements of the Act in respect of registration. It may be registered as 'limited by shares' or 'limited by guarantee." The words "One Person Company" shall be mentioned in brackets below the name of such company, wherever its name is printed, affixed or engraved. In India, only adult natural person who is an Indian citizen and resident in India shall be eligible to incorporate a One Person Company (OPC).

There are lots of relaxations available under the Act, some of them are as under:

a) There is no need to prepare a cash flow statement.

b) There is no necessity for Annual General Meeting to be held.

c) The annual return can be signed by the Director and not necessarily a Company Secretary.

d) An OPC need to hold only one meeting of the Board of Directors in each half of a calendar year and the gap between two meetings should not be less than 90 days.

(ii) Small Company: Section 2(85) of the Companies Act 2013 defines it as, "small company means a company other than a public company " with :-

a) Paid-up share capital not exceeding Rs.50 lakh; and

b) Turnover as per its last profit and loss account does not exceed Rs. 2 crores. You should note that One Person Company or small company cannot be formed as a non-profit association.

(2) Public Company [Section 2 (71)]

As per section 2(71), a public company means a company which-

a) is not a private company;

b) has a minimum paid-up share capital, as may be prescribed or such higher amount as may be prescribed which shall not be more than Rs. 5 crores.

Features of a public company are:

(i) It can invite the public to subscribe to its shares and debentures by open invitation.

(ii) A minimum of seven members are required to establish a public company. There is no limit on the maximum number of its members.

(iii) There is no restriction on the transfer of shares i.e., the shareholders are free to sell their shares to the public.

(iv) The public company must have a minimum paid up capital of five lakhs rupees.

(v) It must write the word "Limited" after its name.

Reliance Industries Limited, Bajaj Auto Limited, Hindustan lever Limited, Steel Authority of India Limited are examples of public companies.

Table showing Some key points of differences in applicability of various provisions of the Companies Act, 2013 between a Public Limited Company and a Private Limited Company:

Sr. No.	Section	Brief Description	Private Limited Company	Public Limited Company
1	2	Meaning	Minimum Capital Rs. 100000 Right to transfer the shares : Restricted	Minimum Capital Rs. 500000 Subsidiary of a public Co. is deemed to be a Public Co.
2	3	No. of members Required	Min. 2 (Two), Max. 200 (Two Hundred)	Min. 7 (Seven) Max. No Limit
3	4	Name of the Company	"Private Limited" as last word	"Public limited" as last word
4	23	Issue of Securities	By way of Right Issue or Bonus Issue through Private Placement	To public through Prospectus ("Public Offer") by way of Right Issue or Bonus Issue through Private Placement
5	149	No. of Directors and Independent Directors	2 (Two) not required to appoint Independent Directors	3 (Three) and Incase of Listed Companies, at least One-Third as Independent Directors

Note:

1. As per the Companies Amendment Act 2015, the clause related to minimum paid-up capital has been removed ,thereby necessitating no minimum capital requirement for starting a private and public limited company.

2. As per the Companies Amendment Act 2015, both private & public limited company can start business activities immediately after receiving certificate of incorporation.

5.4 MERITS OF JOINT STOCK COMPANY

A company form of business organisation is very popular for undertaking big business. It has the following merits -

(a) **Large Resources:** A joint stock company can raise large financial resources because of its large number of members and it can raise funds through shares, debentures, public deposits, loans from financial institutions without much difficulty.

(b) **Limited Liability:** In a joint stock company the liability of its members is limited to the extent of shares held by them. This attracts a large number of small investors to invest in the company. It helps the company to raise huge capital. Because of its limited liability, a company is also able to take larger risks. This helps in making investment decisions easily.

(c) **Continuity of Existence:** A company is an artificial person created by law and possesses independent legal status. It is not affected by the death, insolvency etc. of its members. Thus, it has a perpetual existence.

(d) **Benefits of Large-scale Operation:** The joint stock company is the only form of business organisation which can provide capital for large-scale operations. It results in large-scale production consequently leading to increase in efficiency and reduction in the cost of operation. It further opens the scope for expansion.

(e) **Liquidity:** The transferability of shares acts as an added incentive to investors as the shares of a public company can be traded easily in the stock exchange such as NSE and BSE. The public can buy shares when they have money to invest and convert shares into cash when they need money. For this, they have to open a DMAT Account.

(f) **Professional Management:** Companies, because of the complex nature of their activities and large volume of business, require professional managers at every level of organisation. Because of the size of their business and the financial strength they can afford to appoint such managers. This leads to efficiency in management of their affairs.

(g) **Research and Development:** A company generally invests a lot of money on research and development for improved processes of production, designing and innovating new products, improving quality of products, new ways of training to its staff, etc.

(h) **Tax Benefits:** Although the companies are required to pay tax at a high rate, in effect their tax burden is low as they enjoy many tax exemptions under the Income Tax Act. In spite of several merits of a joint stock company as discussed above, this form of business organisation also suffers from many limitations. The important limitations are given below:

5.5 LIMITATIONS OF JOINT STOCK COMPANY

Inspite of several merits of a joint stock company as discussed above, thia form of business organisation also suffers from many limitaions. The important limitations are given below:

(a) Difficult to Form: The formation of a company involves compliance with a number of legal formalities under the Companies Act and compliance with several other rules and regulations framed by the government from time to time.

(b) Control by a Group: Theoretically a company is supposed to be managed by trained and experienced Directors. But practically this is not so in many cases. Most of the companies are managed by the Directors belonging to the same family. Since most of the shareholders are widely dispersed, they have indifferent attitude towards the management of the company. The shareholders holding majority of the shares take all decisions on behalf of the company. Thus, the democratic virtues of a company do not really exist in practice.

(c) Excessive Government Control: A company is expected to comply with the provisions of several Acts. Non-compl iance with these, invites heavy penalty. This affects the smooth functioning of the companies.

(d) Delay in Decision Making: A company has to fulfill certain procedural formalities before making certain decisions, as they require the approval of the Board of Directors and /or the General Body of shareholders. Such formalities are time consuming and therefore, some important decisions may be delayed.

(e) Lack of Secrecy: It is difficult to maintain secrecy in many matters as they may require approval of board of directors and/or general body whose proceedings are usually open to public.

(f) Social abuses: A joint stock company is a large-scale business organisation having huge resources. This provides a lot of power to them. Any misuse of such power creates unhealthy conditions in the society e.g. having monopoly of a particular business, industry or product; influencing politicians and government for getting their work done; exploiting workers, consumers and investors, etc.

5.6 SUITABILITY OF JOINT STOCK COMPANY

A joint stock company is suitable where the volume of business is large, the area of operation is widespread, the risk involved is high and there is a need for huge financial resources and manpower. It is also preferred when there is need for professional management in its operations. In certain businesses like banking and insurance, joint stock company form is the most suitable. Now-a-days, it is a preferred form for most areas of business because of the preference for operating on a large scale.

5.7 CHOOSING THE RIGHT FORM OF BUSINESS

You have already learnt about different forms of business ownership, i.e., Sole Proprietorship, Partnership, Joint Hindu Family Business, Company and Cooperative Society. You must have noticed

that no particular form of business organisation can meet all our requirements. Some may require more financial and managerial resources while others involve large risk. That is the reason why we find different forms of business organisations prevailing in our economy. So while selecting a form of business organisation, we analyse different factors and try to choose the most suitable form according to our financial and managerial capabilities. We will now study those factors which may help us in selecting the right form of business organisation.

(a) **Ease of formation:** A sole trader can commence and withdraw from business at any time at his own wish. In partnership, mutual trust and faith is very much required. Company requires many legal formalities for its formation. Sole proprietorship is therefore the easiest to form.

(b) **Availability of Large Resources:** One-man business is the best in the world if the owner has enough resources and ability to manage. This statement shows that a single person is unable to undertake big business mainly because of limited resources and managerial ability. In partnership also, the financial resources of partners are limited. Therefore, only a company can raise enough capital and hire expert knowledge required for the management of a big business.

(c) **Liability or Risk:** We know that liability of members is unlimited both in sole proprietorship and partnership firm and limited in case of a company and ooperative societies. Since members hesitate to undertake big risk, they prefer to invest in a company.

(d) **Stability:** Stability is essential for the success of any business. The existence of a company and cooperative society does not depend on the health and wealth of its members. Sole proprietorship and partnership forms are dissolved but company form of an organisation continues irrespective of the death or insolvency of any of its members.

(e) **Flexibility:** An ideal form of business must have flexibility in operations. Decisions must be taken quickly and implemented promptly for its functioning. Any rigidity in its functioning will not be beneficial for the survival and growth of a business. A company enjoys better flexibility whenever more finances are required. It can raise more capital and include more members whenever needed. In a partnership, the number of members at any time cannot exceed 50. In sole proprietorship there is only one owner and availability of finances is also limited.

But flexibility in operations is maximum in sole proprietorship. The owner does not require approval of other members as in partnership or compliance with the provisions of the Act as in a company. Hence, change in the nature of business or its operations is easiest in the case of sole proprietorship.

(f) **Secrecy:** The sole trader is the master of his entire business. He does not need to share his secrets with anyone. Partnership is organised on the basis of mutual agency and therefore all the partners have the right to know everything about the business. A company is required to file a number of documents and publish its annual reports. Therefore, secrecy is the least in case of a company.

(g) Extent of State Control: While it is not possible altogether to avoid compliance with governmental regulations the entrepreneur will always like to choose that form of business organisation which has minimum government interference. A company has to fulfill many legal formalities before it can commence its business. Even after the formation, it has to comply with various legal provisions. In sole proprietorship and partnership, the government control is comparatively less.

5.8 FORMATION OF A COMPANY

The Company formation is the process of registering a business as a limited company as per the Companies Act. The formation of a company is a procedure of incorporation of a company. It includes various factors and legal documents for the purpose of incorporation. For convenience the whole process of formation of a company may be divided into FOUR stages, namely:

(i) Promotion stage

(ii) Registration/Incorporation stage

(iii) Capital Subscription stage

(iv) Commencement of Business stage

Let us discuss each stage of formation of company:

5.8.1 PROMOTION STAGE

A company form of business does not come into existence on its own, since it an artificial person, as a result of the efforts of an individual or group of people or an institution. That is, it is promoted by some person or persons. The persons who assumes the task of promotion are called promoters. This stage includes the following:

(i) Discovery of an Idea: The process of promotion begins with the conceiving of an idea and ends when that idea is translated into action.

(ii) Take action: Mere conceiving an idea is not important but it should be translated into action. For which it requires a detailed investigation for which collection of particular data from the right sources in the market is necessary. Thereafter, there is a need of the time to assemble the resources of the company and keep it in a safe place and prepare it for your company's formation.

(a) Who is a promoter?

The person who is concerned with the promotion of business is known as promoter. He conceives the idea of starting a business and takes all the measures required for bringing the enterprise into existence. For example; Dhirubhai Ambani is the promoter of Reliance Industries. Section 2(69) of the Companies Act, 2013 defines the term promoter as a person**.**

i. Who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or

ii. Who has control over the affairs of the company, directly or indirectly whether as a shareholder; director or otherwise, or

iii. In accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act.

The promoter finds out the ways to collect money, investigate business ideas, arrange for finance, assemble resources and establishes a functioning concern. The Company Law has not given any legal status to promoters. He stands in a fiduciary position.

5.8.2 REGISTRATION STAGE

It is registration that brings a company into existence. A company is properly formed only when it is duly registered under the Companies Act. Procedure for registration: In order to get the company registered, the important documents required to be filed with the Registrar of Companies are as follows:

(a) **Memorandum of Association:** It is to be signed by a minimum of 7 people for a public company and by 2 in case of private company. It must be properly stamped.

(b) **Article of Association:** This document is signed by all those persons who have signed the Memorandum of Association.

(c) **List of Directors:** A list of directors with their names, addresses and occupations is to be prepared and filed with the Registrar of Companies.

(d) **Written consent of the Directors:** A written consent of the directors that they have agreed to act as directors has to be filed with the Registrar along with a written undertaking to the effect that they will take qualification shares and will pay for them.

(e) **Notice of the Address of the Registered Office:** It is also customary to file the notice of the address of the company's registered office at the time of incorporation. It is to be given within 30 days after the date of incorporation.

(f) **Statutory Declaration:** A statutory declaration to the effect that all the requirements of this Act and the rules made there under in respect of registration and matter precedent or incident thereto have been complied with; is also to be filed . The statutory declaration is to be signed by:

i. Any advocate of the Supreme Court, or

ii. Any advocate of a High Court, or

iii. An attorney or pleader entitled to appear before a High Court, or

iv. A practicing Chartered Accountant in India, who engages in the company formation, or

v. A person indicated in the article as director, managing director, secretary or a manager of the company, mentioning that the requisites of the Act and the rules there under have been complied with. It is to be filed with the Registrar of Companies. When the required documents have been filed with the Registrar along with the prescribed fee, the Registrar scrutinizes the documents. If the Registrar is satisfied, the name of the company is entered in the register. Then the Registrar issues a certificate known as Certificate of Incorporation.

5.8.3 CERTIFICATE OF INCORPORATION

After scrutinising the documents filed and on being satisfied that they are in order, thatthe requisite fee has been paid and that all other legal requirements have been duly complied with, the Registrar will enter the name of the company in the Register of Companies and shall certify under his hand that the company is incorporated and, in the case of a limited company that the company is limited. He would then issue a Certificate in the prescribed form under his signature, certifying that the company is incorporated. The certificate contains:

i. The name of company,

ii. The date of issue, and

iii. The signature of the Registrar with his seal.

The Certificate of Incorporation constitutes the company's birth certificate and the company becomes a body corporate. The company comes into existence on the date given in the Certificate of Incorporation.

Allotment of Corporate Identity Number (CIN): The Registrar shall allot to the company a CIN, which shall be a distinct identity for the company and which shall also be included in the certificate.

The Ministry of Corporate Affairs has allowed issue of Certificate of Incorporation electronically under digital signature of the Registrar.

5.8.4 CERTIFICATE OF COMMENCEMENT OF BUSINESS

Section 11 of the Companies Act 2013 has been omitted by the Companies (Amendment) Act, 2015, thereby permitting all companies, whether private or public, to commence business immediately after obtaining Certificate of Incorporation.

5.9 MULTI NATIONAL COMPANY

In our day-to-day, life we use different goods of India as well as from foreign countries. The foreign goods are either imported to our country or these goods are produced in our country by the foreign companies. You must be thinking why foreign companies are coming to our country. Actually, they came to India to produce goods and services and/ or to sell their products. Similarly, Indian Companies are also extending their business operations across the boundaries of our country. This is called globalization, which means extension of economic activities across the boundaries of a country in search of worldwide markets.

5.9.1 MEANING AND FEATURES OF MULTINATIONAL CORPORATION

Simply speaking, a multinational corporation (also termed as multinational company is one which is registered as a company in one country but carries on business in a number of other countries by setting up factories, branches or subsidiary units. Such a company may produce goods or arrange services in one or more countries and sell these in the same or other countries. You might have heard about many Multinational Corporations (MNCs) running business in India, like Hyundai Motor Company, Coca Cola Company, Sony Corporation, McDonald's Corporation, Citi Bank, etc.

All these corporations generally have production, marketing and other facilities in several countries. Their volume of sales, profits earned, and also the value of assets held by them is generally very large. They have set up their branches and subsidiary units in our country and also in other countries. They are controlled from the headquarters of these companies in the home country, which lay down broad policies to be pursued.

Features of Global Enterprises (MNCs)

The main features of a multinational company are the following:

1. **Centralised Management:** A multinational company has its headquarter in the home country. It expands its business in host countries by opening branches and subsidiary companies in other countries. The management of the business being carried out in other countries is in the hands of the head office. All the branches and subsidiaries have to work according to the policies laid down by the head office.

2. **Worldwide Spread of Business:** The business of the multinational company is spread in many countries. This company fully exploits the local conditions prevailing in the host countries. This includes the availability of cheap labour and the use of raw material.

3. **Better Quality Products:** A multinational company has to compete on the world level, it has, therefore, to pay special attention to the quality of its products.

4. **Large Size:** A multinational company has huge assets. The value of the assets of IBM is approximately 8 billion dollars. Similarly, another company ITT has 800 branches in 70 countries.

5. **Access to International Market:** A multinational company easily establishes its identity in the international market because of its many products, good quality, research on a large scale, good marketing facilities, etc.

6. **Special Attention to Advertisement:** A multinational company pays special attention to advertisement. That is the secret of its success.

5.9.2 ADVANTAGES OF MULTINATIONAL CORPORATION

The Multinational Corporations enjoy several advantages by way of huge earnings due to large-scale production and distribution activities across national borders. Besides, the host countries in which the Multinational Corporations operate also derive a number of advantages. These are:

(a) Investment of Foreign Capital: Direct investment of capital by multinational corporation helps under-developed countries to speed up their economic development.

(b) Generation of Employment: Expansion of industrial and trading activities by multinational corporation leads to creation of employment opportunities and raising the standard of living in host countries.

(c) Use of Advanced Technology: With substantial resources multinational corporations undertake Research and Development activities which contribute to improved methods and processes of production and thus, increase the quality of products. Gradually, other countries also acquire these technologies.

(d) Growth of Ancillary Units: Suppliers of materials and services and ancillary industries often grow in host countries as a result of the operation of multinational corporations.

(e) Increase in Exports and Inflow of Foreign Exchange: Goods produced in the host countries are sometimes exported by multinational corporation. Foreign exchange thus earned contributes to the foreign exchange reserves of host countries.

(f) Healthy Competition: Efficient production of quality goods by multinational corporations prompt the domestic producers to improve their performance in Physics order to survive in the market.

5.9.3 LIMITATIONS OF MULTINATIONAL CORPORATION

The advantages discussed above are no doubt beneficial to host countries. But there are several limitations of multinational corporations, which we should take note of:

(a) Least Concern for Priorities of Host Countries: Multinational corporations generally invest capital in the most profitable industries and do not take into account the priorities of developing basic industries and services in backward regions of the host country.

(b) Adverse Effect on Domestic Enterprises: Due to large-scale operations and technological skills, multinational corporations are often able to dominate the markets in host countries and tend to acquire monopoly power. Thus, many local enterprises are compelled to close down.

(c) Change in Culture: Consumer goods, which are introduced by multinational corporations in the host countries, do not generally conform to the local cultural norms. Thus, consumption habits of people regarding food and dress tend to change away from their own cultural heritage.

5.10 JOINT VENTURES

Joint venture is a form of business, where two or more independent firms contribute capital and participate in business operations, these two organisations may be private or government organisations or a foreign company. In joint venture, business concerns join together for a specified purpose. It facilitates pooling funds, technical knowhow & managerial skills. The rewards and risks will be shared

by the concerns in joint venture. e.g. Maruti Ltd. of India and Suzuki Ltd. of Japan joined hands to form Maruti Suzuki India Ltd. which is a joint venture concern.

Features of Joint Venture

1. **Access to advanced Technology:** When two or more companies join together, there can be access to latest techniques of production. This will lead to cost reduction and improvement in quality and increased production.

2. **Optimum Use of Capital:** Joint Venture helps in the optimum utilisation of capital. There will be least wastage of capital and other resources.

3. **Pooling of Resources and Expertise:** The resources of two or more companies can be effectively pooled by forming a joint venture. This helps in large scale production and can avail economies of large scale production.

4. **Innovation:** In the highly competitive market, the ideas and technology of two enterprises will help to innovative new ideas and products.

5. **Sharing of Risk and Reward:** The enterprises which join hands to form joint venture will share the reward in the form of increased profit. The partners in joint venture have to share the risk that may occur in business.

5.11 PUBLIC PRIVATE PARTNERSHIP

Public Private Partnership means partnership between public sector and private sector in financing, designing and developing infrastructural facilities. In a PPP, the private sector may contribute money, expertise and technical knowhow. Infrastructures like power, transport, education, healthcare, waste management etc. are maintained through PPPs.

Features of Public Private Partnership

1. PPP projects are for the benefit of public.

2. Government remains actively involved throughout the life of a PPP project.

3. PPPs are mainly used in government projects of higher priority.

4. In a PPP project, the funds, expertise and experience of both the private and public sectors are combined.

5. In a PPP project, the degree of responsibility and the level of risk are shared between private and public sector.

Merits of Public Private Partnership

1. PPPs approach helps in faster implementation of projects.

2. It helps in higher quality services as there is a combined expertise of public and private sector.

3. It helps to reduce costs due to efficient management practices.

4. In PPPs the risk is divided between the government and the private sector.

5. In PPPs, the funds are invested both by the public and the private sector. So government is relieved of the botheration of borrowing money.

6. The government is accountable for the cost and quality of public services.

Demerits of Public Private Partnership

1. Private sector aims at profit maximisation, but such an approach may not be desirable for public works.

2. There is possibility of leakage of important secrets of the country.

3. Sometimes there may be delays in the completion of crucial projects because of the conflicts between the government and the private firm.

5.12 CONCEPT OF PRIVATE AND PUBLIC ENTERPRISES

As you know that there are two paths of economic development; one via Direct Productive Activities in which government as well as private entrepreneurs take initiative of establishing industries which are not only vital but also desirable to develop a base through which other allied productive activities can also be developed. And second via Social Overhead Capital such as transport facilities, electricity facilities, water facilities, drainage facilities etc. in which a huge investment is necessary without which the development of productive activities will go slow. Hence, both the sectors have to play their role. Thus, the existence of private sector and public sector are indispensable as both the paths are interdependent. In the beginning, the government of India had chosen the path of investing in direct productive activities by establishing basic industries like five steal plants with the collaboration of a foreign country. Thereafter the development process took a speed.

You have learnt the different forms of business organisation of private sector enterprises like sole proprietorship, partnership firm and company whose primary aim is to make money and serving the society is tertiary. Private sector enterprises do not operate in areas where profit margins are very meager or low and they are not directly accountable for welfare of the general public but the Companies Act 2013 entrusted in private sector enterprises to spend at least 2% of its average profit of last three years as corporate social responsibility. Although they are contributing to the exchequer in the orm of tax and in the economic growth of the country, but do not indulge in the development of social overhead capital without which the development of economy in not possible. The distribution of wealth is equitable because of that the rich get richer and the poor get poorer. Hence, the government has to play an important role as per the Directive Principles of State Policy by setting up public enterprises.

The genesis of the origin of public enterprise is governed by the Directive Principles of State Policy which provides guiding principles for governance but is not enforceable by any court. These principles provide the social and economic guidance for Indian Democracy and pave the way for the establishment

of a true welfare state. It commands the State and its instrumentalities to follow certain fundamental principles while formulating and pursuing policies.

The Directive Principles envision for all citizens the equality of opportunity and adequate means of livelihood, avoiding concentration of wealth in few hands. In other words, it envisages equality, liberty and freedom.

The Industrial Policy Resolution, 1956, set the mood and tone for the future. While reserving the key and basic industries for the public sector, it made it clear its intention to follow the socialistic pattern of governance that the private enterprise and initiative were to be provided all possible opportunities and incentive for growth within the parameters by planned economic development.

5.12.1 PRIVATE SECTOR ENTERPRISE

In the mixed economy of India, private sector plays a complementary role to the public sector. The private enterprises are the businesses that are owned by a private group or an individual. Different types of businesses under private enterprises are a sole proprietorship, partnership, cooperative and company. It consists of business activity owned and run by private individuals. The goals of private enterprise are to make profits.

Its main characteristics are:

a) Private ownership

b) Private management

c) Private finance

d) Profit objective

e) Private accountability

Advantages and disadvantages of private enterprise

	Advantages	Disadvantages
1	Private Services or owned by Private Enterprise and therefore are seen to be cheaper to run	If the public enterprise does not make profit then it might have to backed by public tax payer.
2	Private enterprise have more control in terms of wages and costing of the service.	If private enterprise is running in debt, then they were backed by the government so that people can use the services
3	They can use their companies to invest for the future to improve sustainability.	Prices can be increased for services according to the economy.

5.12.2 MEANING OF PUBLIC ENTERPRISE

The term PSU or PSU Companies represents the group of Companies in India owned by the union government of India, or one of the many state or territorial governments, or both. In a PSU Company, the majority of the shares (51% or more) are owned by Central or State Government. Currently there are just three sectors left reserved only for the government i.e., Railway, Atomic energy and explosive material. Private sectors/ players are not allowed to operate in these sectors.

In India, public enterprises have been assigned the task of realising the objectives laid down in the Directive Principles of State Policy which aims to prevent concentration of economic power and growth of private monopoly and helps the government to enforce social control on trade and industry for ensuring equitable distribution of goods and services.

5.12.3 CHARACTERISTICS OF PUBLIC ENTERPRISE

(a) **State ownership and control:** The public enterprises are established by the special act of Parliament, or Company Act or other acts. It is owned, and managed by the central or state government or by the local authority and controlled through a public authority. The government may either wholly own the public enterprises or the ownership may partly be with the government and partly with the private industrialists and the public. In any case, the control, management and ownership remain primarily with the government. For example,

National Thermal Power Corporation (NTPC) is an industrial organisation established by the Central Government and part of its share capital is provided by the public.

(b) **State financing:** The public enterprises get their capital from Government funds ranging from more than 50% to 100% and the government has to make provision for their capital in its general budget.

(c) **Socio-economic objectives:** The Public enterprises are not guided by a profit motive but have a social welfare motive. Their major focus is on providing the service or commodity to public at a reasonable price. They also generate profit and pay tax and dividend to the government. Take the case of Indian Oil Corporation or GAIL India Limited. They provide petroleum and gas at subsidized prices to the public.

(d) **Public accountability:** They are accountable to the parliament for their performance. CAG reports the performance to the parliament.

(e) **Excessive Formalities:** The government rules and regulations force the public enterprises to observe excessive formalities in their operations. This makes the task of management very sensitive and cumbersome.

(f) **Autonomy:** Public enterprises enjoy autonomy or semi-autonomy in operations. The government does not interfere in their day-to-day functioning.

5.12.4 OBJECTIVES OF PUBLIC ENTERPRISES CAN BE SUMMARIZED AS UNDER

The public sector aims at achieving the following objectives:

a) To promote rapid economic development through creation and expansion of infrastructure.

b) To generate financial resources for development

c) To promote redistribution of income and wealth

d) To create employment opportunities

e) To promote balanced regional growth

f) To encourage the development of small-scale and ancillary industries, and

g) To accelerate export promotion and import substitution.

5.12.5 ADVANTAGES AND DISADVANTAGES OF PUBLIC ENTERPRISE

	Advantages	Disadvantages
1	The Public controlled the services. Therefore profit margins are kept low.	All the money that is used comes from the pocket of taxpayer. Therefore would not get the best value for money.
2	The cost of public services are covered from the taxpayer, therefore cannot go too much into debt.	There is less competition from private enterprises, therefore not allowing private enterprise to grow.
3	They are directly controlled by the government and therefore cannot be used inappropriately.	Some organizations are very expensive to run and could cause a lot of money being used from taxpayer.
4	All the essential services will be free or subsidized and won't / little charge the public to use them. (such as school and hospital)	Autonomy on papers only.

5.12.6 DIFFERENCE BETWEEN PUBLIC ENTERPRISE AND PRIVATE ENTERPRISE

S.No	Basis of difference	Public Enterprise	Private Enterprise
1.	Objective	Maximisation of profit.	Maximise social welfare economic and ensure balanced development.
2.	Ownership	Owned by individuals or group of individuals	Owned by Government.
3.	Management	Managed by owner and professional managers.	Managed by Government.
4.	Capital	Raised by owners through loans, private sources and public issues.	Raised from Government funds and sometimes through public issues.
5.	Area of operation	Operates in all areas with adequate return	Operates in basic and public utility sectors. on investment.

5.13 FORM OF PUBLIC SECTOR ENTERPRISES

Public enterprises are operated into three forms which are

(1) Departmental Undertaking;

(2) Statutory (or Public) Corporation and

(3) Government Company

5.13.1 DEPARTMENTAL UNDERTAKING

Departmental Undertakings are that form of organisation which is run as a department of the government and each such department is headed by a minister who is responsible to the Parliament and lays down the general policy for such department. All policy matters and other decisions are taken by the controlling ministry and primarily used for provision of essential services such as railways, post and telegraph services, broadcasting, munitions factories etc. Such organisations function under the overall control of a ministry of the Government and are financed through general budget and controlled in the same way as any other government department. This form is considered suitable for activities where the government desires to have control over them in view of the public interest.

Fig. : 5.1 Rail ways- Departmental Undertaking

Features of Departmental Undertaking:

The main features of departmental undertakings are as follows:

i. It is established by the government and its overall control rests with the minister of such department.

ii. It is a part of the government and is managed like any other government department.

iii. It is financed through government funds.

iv. It is subject to budgetary accounting and audit control.

v. Its policy is laid down by the government and it is accountable to the legislature.

Merits of Departmental Undertakings:

The following are the merits of departmental undertakings:

(a) **Fulfillment of Social Objectives:** The government has full control over these undertakings. As such it can fulfill its social and economic objectives. For example, opening of post offices in far off places, broadcasting and telecasting programmes, which may lead to the social, economic and intellectual development of the people, are the social objectives that the departmental undertakings try to fulfill.

(b) **Responsible to Legislature:** Questions may be raised about the working of departmental undertaking in the parliament and the concerned minister has to satisfy the public with his replies. As such they cannot take any step, which may harm the interest of any particular group of public. These undertakings are responsible to the public through the parliament.

(c) **Control over Economic Activities:** It helps the government to exercise control over the specialised economic activities and can act as an instrument in making social and economic policy.

(d) Contribution to Government Revenue: The surplus (earnings), if any, of the departmental undertakings belongs to the government treasury. This leads to increase in government income. Similarly, if there is deficiency, it is to be met by the government and resulting in the more tax burden on the public.

(e) Little Scope for Misuse of Funds: Since such undertakings are subject to budgetary accounting and audit control, the possibilities of misuse of their funds are considerably reduced.

Limitations of Departmental Undertakings

Departmental undertakings suffer from the following limitations:

(a) The Influence of Bureaucracy: On account of government control, a departmental undertaking suffers from all the ills of bureaucratic functioning. For instance, government permission is required for each expenditure, observance of government decisions regarding appointment and promotion of the employees and so on. Because of these reasons important decisions get delayed due to red-tapism and the organisation is not capitalising on new opportunities. On account of these reasons some difficulties come in the way of working of departmental undertakings.

(b) Excessive Parliamentary Control: On account of the excessive Parliamentary scrutiny, government audits etc. stifle creativity and increase amount of paper work and records maintenance comes in the way of day-to-day administration. This is also because questions are repeatedly asked in the parliament about the working of the undertaking.

(c) Lack of Professional Expertise: The administrative officers are civil servants who manage the affairs but do not possess knowledge and experience or expertise of the business in which undertaking is involved. Hence, these undertakings are not managed in a professional manner resulting poor and late decision-making causing deficiency leading to excessive drainage of public funds.

(d) Lack of Flexibility: Flexibility means autonomy in correction in policy and operations as per need of the hour which lacks in departmental undertaking due to centralisation of control.

(e) Inefficient Functioning: Such organisations suffer from inefficiency on account of incompetent staff and lack of adequate incentives to improve efficiency of the employees.

5.13.2 STATUTORY (PUBLIC) CORPORATION

The Statutory Corporation (or Public Corporation) refers to such organisations which are incorporated under the special Acts of the Parliament/State Legislative Assemblies. Its management pattern, its powers and functions, the area of activity, rules and regulations for its employees and its relationship with government departments, etc. are specified in the concerned Act. Examples of statutory corporations are State Bank of India, Life Insurance Corporation of India, Industrial Finance Corporation of India, etc. It may be noted that more than one corporation can also be established under the same Act. State Electricity Boards and State Financial Corporations fall in this category.

Fig. : 5.2 Statutory Corporation

Features of Statutory Corporations

The main features of Statutory Corporations are as follows:

(a) It is incorporated under a special Act of Parliament or State Legislative Assembly.

(b) It is an autonomous body and is free from government control in respect of its internal management. However, it is accountable to parliament and state legislature.

(c) It has a separate legal existence. Its capital is wholly provided by the government.

(d) It is managed by the Board of Directors, which is composed of individuals who are trained and experienced in business management. The members of the Board of Directors are nominated by the government.

(e) It is supposed to be self-sufficient in financial matters. However, in case of necessity it may take loan and/or seek assistance from the government.

(f) The employees of these enterprises are recruited, remunerated and governed as per their own requirement under the terms and conditions of recruitment decided by the Board.

Merits of Statutory Corporations

Statutory Corporation as a form of organisation for public enterprises has certain advantages that can be summarised as follows:

(a) Professional Management: It has the advantages of both the departmental and private undertakings. These enterprises are run on business principles under the guidance of expert and experienced Board of Directors consisting of business experts and representatives of wide and various experience and expert groups.

(b) Internal Autonomy: Government has no direct interference in the day-to-day management of these corporations. Decisions can be taken promptly without any hindrance as there are less formalities to be completed before taking any decisions.

(c) Responsible to Parliament: Statutory organisations are responsible to Parliament. Their activities are watched by the press and the public. As such they have to maintain a high level of efficiency and accountability.

(d) Flexibility: As these are independent in matters of management and finance, they enjoy adequate flexibility in their operations. This helps in ensuring good performance and operational results.

(e) Promotion of National Interests: Statutory Corporations protect and promote national interests. The government is authorised to give policy directions to the statutory corporations under the provisions of the Acts governing them.

(f) Easy to Raise Capital: The goodwill of such organisation is as government owned statutory bodies; they can easily raise required capital by floating bonds at a low rate of interest because of the safety factor.

Limitations of Statutory Corporations

Having studied the merits of statutory corporations we may now look to its limitations also. The following limitations are observed in statutory corporations.

(a) Government Interference: It is true that the greatest advantage of statutory corporation is its independence and flexibility, but it is found only on paper for name's sake. In reality, there is excessive government interference in most of the matters.

(b) Rigidity: The amendments to their activities and rights can be made only by the Parliament which is a time-consuming and complicated task. This results in several impediments in business of the corporations to respond to the changing conditions and taking bold decisions.

(c) Ignoring Commercial Approach: The statutory corporations usually face little competition and lack motivation for good performance. Hence, they suffer from gnorance of commercial principles in managing their affairs.

5.13.3 GOVERNMENT UNDERTAKING or COMPANY

Section 2(45) of the companies Act 2013 defines a Government Undertaking as "any company in which not less than 51% of the paid-up share capital is held by the central government, or by any State government or government, or partly by central government and partly by one or more state government and includes a company which is subsidiary company of such a government."

Fig.: 5.3 Government

These companies are registered under Companies Act, 2013 and follow all those rules and regulations as are applicable for any other registered company. The Government of India has organised and registered a number of its undertakings as government companies for ensuring managerial autonomy, operational efficiency and provides competition to private sector.

Features of Government Companies

The main features of Government companies are as follows:

i. It is registered under the Companies Act 2013.

ii. It has a separate legal entity. It can sue and be sued, and can acquire property in its own name.

iii. The annual reports of the government companies are required to be presented in the parliament.

iv. The capital is wholly or partially provided by the government. In case of partially owned company the capital is provided both by the government and private investors. But in such a case the central or state government must own at least 51% shares of the company.

v. It is managed by the Board of Directors. All the Directors or the majority of Directors are appointed by the government, depending upon the extent of private participation.

vi. Its accounting and audit practices are more like those of private enterprises and its auditors are Chartered Accountants appointed by the government.

vii. Its employees are not civil servants. It regulates its personnel policies according to its articles of associations.

Merits of Government Companies

The merits of government company form of organising a public enterprise are as follows:

(a) **Simple Procedure of Establishment:** A government company, as compared to other public enterprises, can be easily formed by as there is no need to get abill passed by the parliament or state legislature. It can be formed simply by following the procedure laid down by the Companies Act just by an executive decision of the government.

(b) **Efficient Working on Business Lines:** The government company can be runon business principles. It is fully independent in financial and administrative matters. Its Board of Directors usually consists of some professionals and independent persons of repute.

(c) **Efficient Management:** As the Annual Report of the government company is placed before both the houses of Parliament for discussion, its management is cautious in carrying out its activities and ensures efficiency in managing the business.

(d) **Healthy Competition:** These companies usually offer a healthy competition to private sector and thus, ensure availability of goods and services at reasonable prices without compromising on the quality.

Limitations of Government Companies

The government companies suffer from the following limitations:

(a) **Lack of Initiative:** The management of government companies always have the fear of public accountability. As a result, they lack initiative in taking rightdecisions at the right time. Moreover, some directors may not take real interest in business for fear of public criticism.

(b) Lack of Business Experience: In practice, the management of these companies is generally put into the hands of administrative service officers who often lack experience in managing the business organisation on professional lines. So, in most cases, they fail to achieve the required efficiency levels.

(c) Change in Policies and Management: The policies and management of these companies generally keep on changing with the change of government. Frequent change of rules, policies and procedures leads to an unhealthy situation of the business enterprises.

5.14 COMPARATIVE VIEW OF DIFFERENT PUBLIC SECTOR UNDERTAKING

Basis	Departmental Undertaking	Public Corporation	Government Company
Establishment	By a Ministry	By the parliament	By a Ministry with or without private participation
Legal Status	No separate entity distinct from the Government	Separate entity to sue and be sued	Separate Corporate existence
Capital	Provided out of budgetary appropriation	Provided wholly by the Government	Part of it may be provided by private enterprenures
Management	Government official from the Ministry concerned	Board of Directors	Board of Directors may include private participation
Control and Accountability	Control rests with the Minister and the Ministry concerned	Parliament	Individuals Government (Ministry concerned)
Autonomy	No autonomy. Works as a part and parcel of government	No governmental interference day-to-day affairs	Some freedom from governmental interference
Suitability	Defence, public utilities	Heavy Industries and service providing enterprises with long gestation period.	All types of Industries and commercial enterprises

5.15 THE ROLE OF PUBLIC SECTOR UNDERTAKING

You know that Indian economy is a mixed one in which the private sector as well as the public sector contribute to the development. However, there are only some selected areas in which the government establishes its enterprises for the balanced development of the economy and promote public welfare. There are several areas where huge investment of capital is necessary but the margin of profit is either meager or it takes long period of time to generate surplus as in case of generation and supply of electricity, machine building, construction of dams, etc. The entrepreneurs of private sectors hesitate to establish their enterprises in these areas but the very few entrepreneurs dare like Jamshed ji TaTa to invest to serve the country in public interest. As such these enterprises are established and run by the

government. Similarly, the public enterprises also help in balanced regional development by promoting industries in every part of the country. For example, with the establishment of Bhilai Steel Plant in Madhya Pradesh several new small industries have come up in that state.

Industrial progress is of utmost importance for the development of the country and for this, it is necessary that some basic industries like oil, coal, gas, iron, steel, production of heavy electrical goods, etc., are to be fully developed. Public enterprises give impetus to the development of these basic industries and also help in the development of the private sector with their products and services. There are some industries which require heavy capital investment on account of technical reasons. Electricity, power, production of gas, heavy machinery tools, production of telephones etc., are such industries.

The development of public enterprises also prevents concentration of economic power in the hands of an individual, or a group of individuals. Not only that, in our country economic inequalities are increasing. Poor are becoming poorer and the rich more rich. The public enterprises can help in reducing inequalities with the help of various policies like utilising the earned profits in public welfare activities and by selling raw material to the small scale industries at lower prices.

It is also necessary for the economic progress of the country that industries which can decrease imports and increase exports are duly promoted. Public enterprises also ensure promotion of such industries.

There is an old belief that the benefits derived from the nature should be made available to all without any distinction. The public enterprises ensure that land, oil, coal, gas, water, electricity and other necessary resources are made available to all at fair prices. The security of the country is supreme. There should be no compromise in ensuring this. The production of fighter aeroplanes, arms and ammunition etc, connected with the security of the country is put under the domain of Public Enterprises for this purpose. Thus, public welfare planned economic development of the country, regional balance, import substitution and checking concentration of economic powers are the major goals achieved through public enterprises.

TERMINAL EXERCISE

Very Short Answer Type Questions

1. In a Joint Stock Company what is meant by the term 'share'?
2. State the meaning of the term 'Company' as per the Companies Act 2013.
3. What is meant by multinational corporation?
4. State the difference between a public company and a private company as far as the commencement of business is concerned.
5. How do you identify a public company and a private company just by seeing their names?
6. What is meant by Public Private Partnership?
7. Name a form of organisation that is formed by combined efforts of two or more independent firms?
8. Define Public Sector Enterprise.
9. What is meant by Public Corporation?
10. State the meaning of Departmental Undertaking.
11. What is a Government Company?
12. Name any two important goals to be achieved through public enterprises.

Short Answer Type Questions

1. State how the company is as artificial person.
2. Enumerate the features of a public company.
3. Distinguish between private company and public company on the basis of members and paid up capital.
4. State the suitability of joint stock company form of business organisation.
5. What conditions are required to be fulfilled by a private company?
6. Give any four features of Departmental Undertakings.
7. Distinguish between private sector and public sector enterprises (by giving any two points of distinction).
8. Explain (a) Fulfillment of social objectives and (b) Control over economic activities as merits of Departmental Undertakings.

9. How do public enterprises help in reducing the economic inequalities in the country?

10. Explain any two limitations of Statutory Corporations.

11. What is meant by 'Joint Venture'? State any two of its features.

Long Answer Type Questions

1. Explain, why the joint stock company form of business organisation is advisable to undertake huge and risky projects.

2. Describe any five characteristics of a Joint Stock Company.

3. You were running your business in partnership, but now you have formed a joint stock company. What difference did you notice in respect of

   (a) legal status (b) liability, and (c) finance

4. Explain any five advantages of a Multinational Corporation for the host country.

5. State any five factors required to be considered while choosing the right form of business organisation.

6. What is meant by public sector enterprises? State in brief its features.

7. How are the public sector enterprises helping in the balanced development of the Indian Economy and promoting public welfare in the country?

8. What is a Government Company? How is it different from Statutory Corporation? Give any five such distinctions.

9. You have heard about various types of Public Sector Enterprises such as Departmental Undertakings, Public Corporations and Government Companies. Taking an example of all three give at least one name and two features of each.

10. You are appearing as a candidate in an interview in a Public Ltd. Co. One of the members of the interview board asks you the difference between a Public Company and a Private Company. Express your views to satisfy the interview board with the help of any five points.

Module 2

Business Management and its Functions

6.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 parttime or fulltime 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 jobs among the family members so that work is carried out 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 parttime maid and so on. Every housewife does all this work in her own way depending upon her understanding, interest and commitment and 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 teachers shall go, how much money is required, where to get the money from , 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 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.

LEARNING OUTCOMES

- describes the concept of business management from the perspective of business management
- explains the importance and nature of business management in a business framework;

- identifies the various levels of management existing in a business organisation; and
- differentiates between principal and function of management to examine business at functional level.

6.1 MEANING AND OBJECTIVES OF MANAGEMENT

6.1.1 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 the 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 the 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. This is because the inputs do not become outputs 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 put to use.

6.1.2 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 themselves 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.

6.2 CHARACTERISTICS OF MANAGEMENT

The various characteristics of management are:

(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 enterprise. 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, sales, storage, operations 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 results. In fact, without integration of men, machine and materials 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 picture showing board meeting or 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, regulations, outputs, 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, materials 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.

(i) Management is Dynamic: Management is a dynamic function and has to adapt itself to the changing environment. An organisation interacts with the external environment. This environment is impacted by various economic, social and political factors. To sustain the organisation needs to adapt its goals according to the evolving external environment.

6.3 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 multi-fold. 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 all employee in the organisation also have their own goals that they want 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 out planning, good direction and proper coordination and control that effectiveness of 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, processes and 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 of human efforts and operations.

6.4 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 accumulated 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 (H2O). Similarly we can say earth moves around the sun.

Any subject of study 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 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 theprofessionals. 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.

6.5 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 following diagram will give you an idea about the functions, positions and relations of different levels of 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.

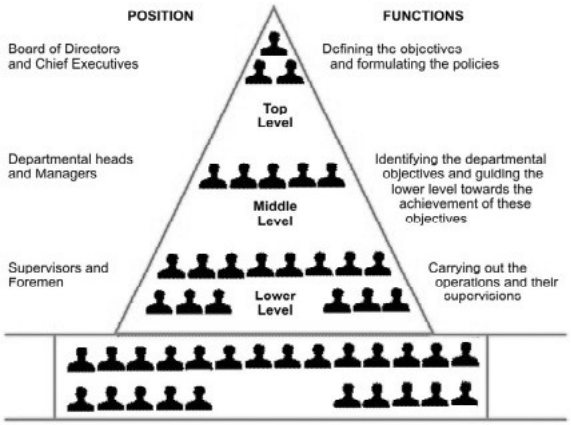


Fig.:6.1

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 operational staff , 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 ach level decreases as one moves from lower level to top level management. At the top of the organisation, there is usually one person.

6.6 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 here under. 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 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 functioning together in accomplishing the objectives. 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 instructions without arousing any resentment among the subordinates. He should keep an eye 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 at 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, regulating operations, removing deficiencies and improving performance.

6.7 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 establish cause and effect relationship and serve as a guide for 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 functioning, it may have adopted principle of centralisation. When the organisation became a large enterprise, it will apply principle of decentralisation.

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 in 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:** The principles act as reference for the managers and help to evaluate whether the decision taken by them are appropriate and accurate.

5. **Increases Efficiency:** The principles are guidelines for managers for taking accurate decisions. Principles help the managers in solving problems of an enterprise.

6.7.1 PRINCIPLES OF SCIENTIFIC MANAGEMENT

Frederick 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 of the problems of management. Taylor developed the following principles for guiding the managers of an organisation. These principles are known as the principles of Scientific Management.

The principles of Scientific Management are :

1. **Development of Science for Each Element of Man's Work:** According to this principle, decisions should be based on facts rather than rule of thumb. The work assigned to a worker should be observed. Each element (time taken, fatigue of worker etc.) of work should be analysed. The purpose of such observation is to decide the best way of performing the job. Taylor stressed that each job should be based on scientific study.

2. **Scientific Selection, Training and Development of Workmen:** 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 nalysis 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 of work should be done by workers.

6.7.2 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 Study:** 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 particular task 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 helps 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 at determining 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 the 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 make the performance of jobs more efficient.

3. **Functional Foremanship:** Under functional foremanship, a worker is supervised by several specialist foremen. Eight foremen control various aspects of production.

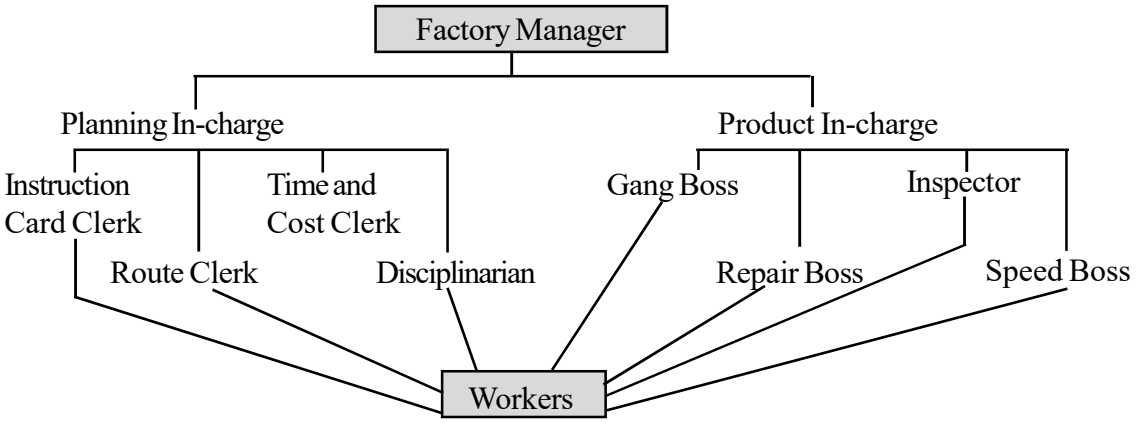


Fig.: 6.2 Functional Foremanship

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 specifies 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 ofproduction. 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, tools and equipments.

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

6.7.3 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 ratesfor 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, Awill 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.

6.8 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 the 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 obligation to perform 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, overexpenditure 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. Fair means it should be in accordance to the paying capacity of company and should be able to provide a reasonable standard of living.

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.

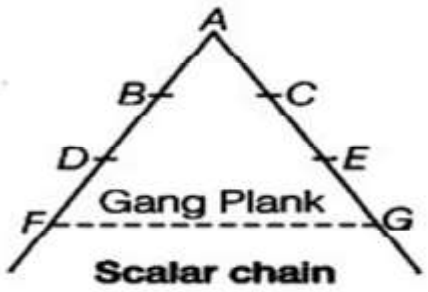


Fig.:6.3

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.

TERMINAL EXERCISE

Very Short Answer Questions

1. Define the term 'Management'.
2. List different levels of management.
3. State the meaning of Esprit de Corps.
4. What is meant by subordination of individual interest to general interest?
5. Define the term 'Equity' as a principle of management.
6. State any one principle of Scientific Management.
7. What is meant by motion study?

Short Answer Questions

8. State any three objectives of management.
9. Mention the different characteristics of management.
10. Explain the meaning of 'management as a discipline'.
11. Can management be treated as a profession? Give reasons in support of your answer.
12. What is meant by scientific management?
13. State any three characteristics of principles of management.
14. Explain the importance of principles of management.
15. What is meant by principles of management?
16. What do you mean by Mental revolution?

Long Answer Questions

17. Describe the characteristics of management.
18. Explain the objectives of management.
19. Describe the importance of management.
20. State the various functions of management.
21. State the fourteen principles of management given by Henry Fayol.
22. Explain any three characteristics of management.
23. Explain management as a discipline and as a group.

7. 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 organisational structure, delegation and decentralization of authority.

LEARNING OUTCOMES

- discribes how a business is planned and what are its distinguishing features;
- distinguishes between the various types of business plans and the planning process; and
- discusses how a business is organised, and assess its hierarchical structure.

7.1 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 admission, transport arrangement and purchase of books, stationery etc. Thus, planning is a systematic way of deciding about and doing things in a purposeful manner. It is one of the basic managerial functions. Before starting with something, the manager must first decide on the objectives and then how these have to be achieved. In the context of management, Planning may be defined as "the process of setting future objectives and deciding on the ways and means of achieving them". The entire process seeks to bridge the gap between where we are and where we want to go. 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."

7.2 FEATURES OF PLANNING

The basic features of planning can be summarised as follows:

(a) Planning is the Primary Function of Management: Planning is the first and the foremost function performed by every manager. It forms the basis of all the other managerial functions. In other words, planning precedes all other managerial functions and provides the very basis for organising, staffing, directing and controlling.

(b) Planning is Goal Directed: Planning is always directed at achieving certain goals. 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: Planning is relevant to all levels of management and also for all functional areas. It is not restricted to only top-level but is done by managers at all levels.

Managers at the top-level plan for the entire organisation. They make plans for long periods 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 (lower-level managers) plan for a workshop for a section of the office. They make plans for short period, i.e., for the next day, next week or next month. Also, planning is required by all the other functions of management. For example, Staffing function plans for the number and the type of personnel required, organisation-wide plans for the entire organisation.

(d) **Planning is Futuristic:** Planning is future-oriented. It is deciding in advance what to do, how to do, when to do etc. It requires collection of information about various matters relating to business and then choosing a course of action for the future. The purpose of planning is to meet the future events effectively and in the best possible manner. For example: the annual production plans are prepared on the basis of sales forecasting.

(e) **Planning is an Intellectual Activity:** Planning 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 choices.

(f) **Planning is a Continuous process.** In organisations, plans are made for a specific period followed by new plans for a further period. Sometimes the conditions or circumstances change demanding the plans to be revised. For example, a sugar factory situated in upper regions of Uttar Pradesh had planned for production of 1,000 tons of sugar during the last quarter of the year. Accordingly, the man agement planned for procurement of sugarcane 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 tons. Thus, planning is a continuous activity in all organisations.

(g) **Planning involves making Choices:** Planning involves choices from various alternatives. Need for planning arises when there are several alternatives to meet the objectives/goals. For example, if the organisation plans to increase its profits there may be several alternatives like- increase in sales revenue, cutting cost of production, increasing the price of the product, increase in advertising and sales promotion etc. The alternatives are evaluated and a choice is made regarding which course of action is to be followed.

(h) **Planning is Flexible:** Planning is a future-oriented activity and thus forecasts are made on the basis of certain assumptions which may not materialise. Hence, plans need to be revised 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.

7.3 IMPORTANCE OF PLANNING

Planning is the first and the foremost function of management. Without planning all the other activities of the organization would be aimless and meaningless. Some of the important features of planning are as follows:

(a) **Planning Provides Direction to Action:** Planning is concerned with predetermining the course of action and stating in advance how the work is to be done. It provides direction to the efforts of the employees. It ensures that the goals and objectives are clearly stated and acts as a guide for decision making. This also leads to unity of direction. The various departments, employees, and resources work in the same direction for achieving the organisational goals.

(b) **Planning Reduces Risk and Uncertainty:** Planning is a future-oriented activity and enables the managers to look ahead and anticipate changes. Thus, it prepares the organisation to deal with uncertainties and unexpected events. Though changes and uncertainties cannot be eliminated but with planning these can be certainly reduced.

(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 corrective action.

(d) **Planning Facilitates Decision-Making:** Planning provides for several alternatives from among which the choice can be made, thus, facilitating decision making for managers. In planning, goals are set in advance and predictions are made for future. These predictions and goals help the managers to take fast decisions.

(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 is Necessary to Facilitate Control:** Planning provides the basis for control. While controlling, the actual results are compared with the pre-determined objectives given by planning. Thus, the periodic reviews of operations can show whether the plans implemented are in the right direction or not.

(g) **Planning begins with the Determination of Objectives and Directed Towards their Achievement:** It keeps the executive vigilant and alert. Managers have to review the progress periodically and recast their strategies to meet the agreed objectives. It should be d that planning also has certain limitations, as the plans are based on certain assumptions and possibly incomplete information. Hence, the management has to be vigilant and provide for necessary flexibility to take care of changed situations.

7.4 LIMITATIONS OF PLANNING

Planning is of great importance to management. Planning is a futuristic exercise and the future is always uncertain. Changes can happen anytime and events may not go as per the laid down plans. Change in government policies, environmental changes, price rise, legal regulations, international market conditions all affect our business plans. Plans then need to be modified. Following are the important limitations of planning:

1. **Rigidity:** The existence of a plan puts managerial activities in a rigid framework. Changes are not always 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, and 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 practical during an emergency. If the benefits derived are not more than the cost of a plan, then it has adverse effects 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:** Sometimes planning may be used to serve individual and group interests and interest of the organisation may get ignored.

6. **False Sense of Security:** Planning may create a false sense of security among the employees of an organisation in the sense that activities will take place as per plan, therefore, there is no need to worry.

*The USA sub-prime mortgage crisis was a multinational financial crisis that occurred between 2007-10 that contributed to 2007-08 global financial crisis.

7.5 THE PLANNING PROCESS

Planning is the first and the foremost function required to achieve the desired results. It 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 Planning 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.

Fig.: 7.1

External Planning Premises relate to conditions outside the business. 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 efficiently.

Internal planning premises relate to conditions prevailing within the 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 agreed objectives . 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 making the best choice. Certain alternatives may not be practical. 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 practical 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.

7. **Review and Follow up:** To ensure that the plans are implemented and results achieved in the desired manner, constant monitoring and follow up is necessary. Thus necessary adjustments and corrections can be made in a timely and relevant manner.

7.6 TYPES OF PLANS

1. **Objectives:** Objectives are the end results towards which all the activities are directed. For example, 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 quantitative terms, and should be achievable within a given time period.

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 move of competitors for the optimum utilisation of resources. A Strategy is a comprehensive plan which indicates the desired future of an organisation. For example,

(i) Tata adopted the strategy of attracting even middle income group to purchase cheaper car (Nano).

(ii) Because of fast labour turnover, IT companies adopted the strategy of appointing not only engineers but also graduates from Mathematics and Physics.

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 example, an organisation may have the 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 example, the procedure for giving training to candidates in an organisation. :

a) Collect the applications from candidates;

b) Verify the scores / mark of each candidate;

c) Verify the area of training needed by each individual (for example, 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;

g) Issue of certificate to each participant on completion of training.

5. **Methods:** A 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 ways of doing work. For example, cloth can be manufactured by labour intensive method or capital intensive method. But the most efficient method is one which will use least amount of 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 example, 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 example, 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 systematic working in the organisation. A 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. For example, developing a new product, training programme, advertising programme etc.

7.7 ORGANISING

The next important function of management after planning is organisng. Once the plans are laid down and objectives have been specified, the next step is to arrange for the resources- men, material, money, methods and machinery and also to decide on the ways and means through which it will be easier to achieve what has been planned. All this is undertaken by the organising function. Suppose a company plans to set up a new plant for soft drinks. 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 the organising function.

Organising can be defined as identifying and grouping of activities in the organisation and bringing together the physical, financial and human resources for developing productive relationship among them for achieving the laid down objectives.

7.8 FEATURES OF ORGANISING

1. **Organising is an Important Function of Management:** Organising is an important function in the process of management. It follows the function of planning and is concerned with bringing the resources together, formulating organisational structure and defining authority and responsibility relationships among job positions.

2. **Organising is a Continuous Process:** It is an ongoing process concerned with identification of activities, grouping of activities, assignment of jobs and establishing the relationships among them.

3. **Organising is Pervasive:** The management function of organising is practised by all managers at all levels. Though, its nature and scope may vary at different levels. Top level management is involved with the entire organisation, middle level management is significantly involved with departmental activities and lower level management is concerned with units and divisions.

4. **Organising is Goal-oriented:** Organising is directed towards achieving the overall goals of the organisation. It harmonises the individual goals with the organisational goals.

5. **Organising Involves Co-ordination:** Organising essentially involves coordination as it secures to strike a balance between the various resources and the efforts of the employees.

6. **Organising is a Group Activity:** Organising establishes the relationship among different employees working in groups/ departments in order to secure cooperation among them.

7. **Organising Establishes Authority-Responsibility Relationships:** Authority is the right to control and command and responsibility is the obligation to carry out the work successfully. Organising establishes the relationships among job positions and employees so as to carry out the tasks successfully.

7.9 IMPORTANCE OF ORGANISING

The organising function is very significant as it helps in the survival and growth of any organisation and equips it to meet the business challenges. By grouping work and people properly, organising facilitates administration, promotes specialization, encourages growth and thus contributes to its success. Some of the points of importance are as follows:

1. **Leads to Specialization:** Organising is based on the concept of division of work and this leads to specialization. The activities are divided, grouped and assigned to different departments depending upon the resources and competence thus developing them as specialized centers.

2. **Optimum Utilization of Resources:** Organising leads to the proper usage and allocation of all material, financial and human and technical resources. Since the entire work is divided into smaller activities there is no duplication of efforts and wastage of resources. This provides for the best possible use of the resources.

3. **Establishes clarity of Authority and Responsibility:** Division of work and delegation of authority clearly defines the relationships and lines of communication in the organisational structure. This further removes confusion and conflicts among the employees.

4. **Enhances Creativity:** Organising by providing well defined areas of work and authority provides sufficient freedom to the employees for independent thinking, new and innovative ideas and initiatives. This encourages creativity.

5. **Expansion and growth:** The process of Organising helps in the growth and diversification of an enterprise by enabling it to deviate from existing norms and taking up new challenges. It allows a business enterprise to add more job positions, departments and even diversify their product lines.

6. **Facilitates Co-ordination:** Organising is also used as a mechanism for maintaining and securing co-ordination among employees, functions and various departments. The activities of the individual employees are well harmonized with the functioning of the department and department's goals with the organisational goals.

7. **Adaptation to Change:** Organising also allows the business to adapt itself to the changes in the business environment. The organisational structure can be easily modified and revised in case of the changed circumstances without altering and compromising its goals and objectives.

7.10 PROCESS OF ORGANISING

The process of organising is explained below:

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 Duties:** After the organiszation is divided into specialized departments/ divisions, the next step is to assign and allot duties to various job positions/employees matching their qualification and skills. The work assigned must match their abilities so as to enable them to perform well and successfully.

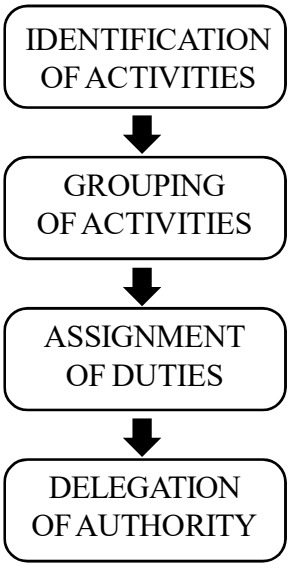


Fig.: 7.2 Process of organising

4. **Delegation of Authority:** Mere assignment of tasks will not ensure their completion until the employees are given the right amount of authority to carry out the task. On the basis of

responsibilities given to employees, they are also to be given the necessary authority to ensure effective performance.

7.11 ORGANISATIONAL STRUCTURE

The process of organising culminates into an organisational structure which constitutes a network of job positions and the authority relationships among the various positions.

The organisation structure can be defined as the framework within which managerial and operating tasks are performed. It defines the relationships between people, work and resources. The whole structure takes the shape of a pyramid and indicates the tasks assigned, hierarchical relationships and the patterns of communication and coordination among individuals.The various factors that are usually taken into consideration for designing a good organisational structure are job specifications, departmentalisation, authority-responsibility relationships, span of control etc. A proper organisational structure is essential to ensure a smooth flow of communication and better control over the operations of a business enterprise.

7.11.1 TYPES OF ORGANISATIONAL STRUCTURE

The organisational structures can be classified as:

(a) Traditional or Bureaucratic Structures

(b) Modern Organisational Structures

(a) Traditional or Bureaucratic Structure:

Based on the arrangement of activities, two most commonly used forms of organisational structure are

(1) Functional Structure, and

(2) Divisional Structure.

These are discussed below:

1. **Functional Structure:** As the name suggests, in a functional structure grouping is based on functions. Similar jobs are grouped into functions and major functions are further categorised as departments which are handled by respective coordinating heads. These departments can further consist of sections. Thus, in any industrial enterprise the functions like manufacturing, marketing, finance, personnel may constitute 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 d that the major units are further divided into subunits. For example, the manufacturing department may be sub-divided into stores, repairs, maintenance, production, etc. This form of organisational structure helps in developing functional specialization in each unit duly headed by an expert in that functional area. This facilitates the co-ordination 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.

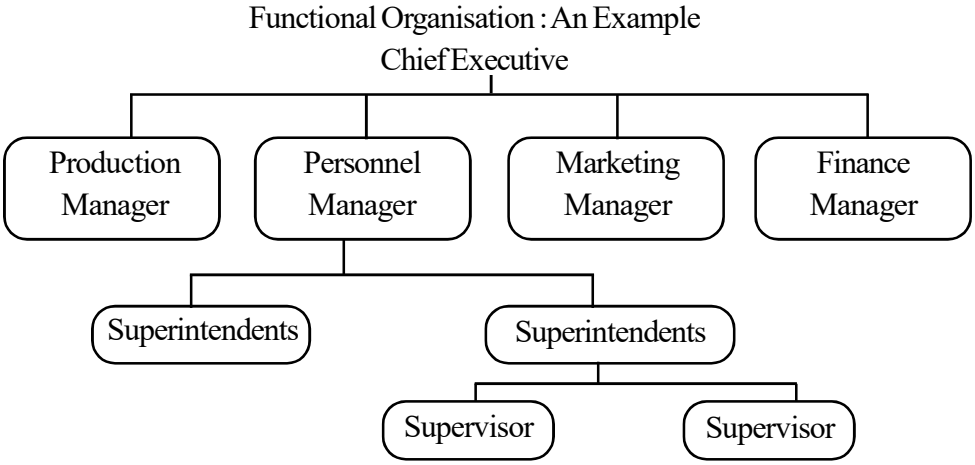


Fig.: 7.3 Functional Organisation : As Example

2. **Divisional Structure:** In large organisations dealing in multiple products and serving anumber of distinctive markets,the divisional structure is considered more suitable. In such structures, the organisation is divided into separate units or divisions which operate independently and are multifunctional. Each unit has a divisional manager at the top that looks after all the operations of the division.

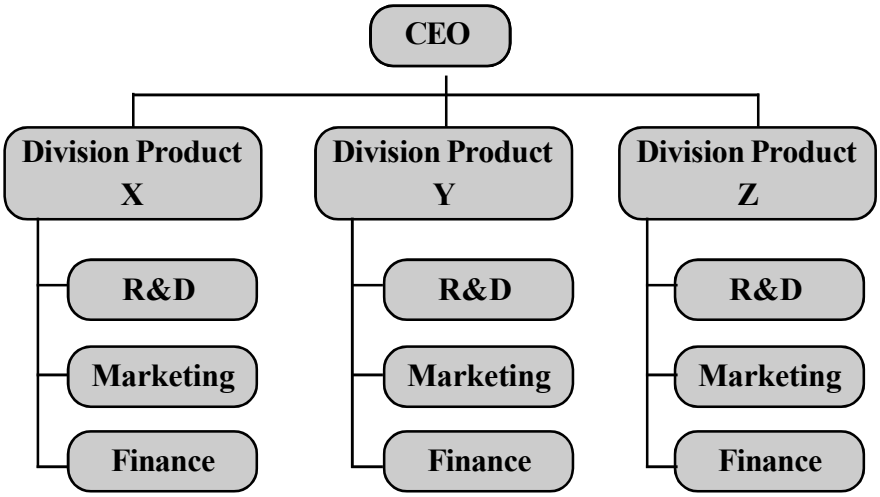


Fig.: 7.4 Divisional Structure

(b) Modern Organization Structures

The traditional organisation structures are hierarchical, rigid, complex and fixed. They have now been replaced with the modern organizational structures which are without boundaries and simple. These structures are well-suited for rapid changes and innovation and therefore ideal for organisations operating in volatile and technology driven environments.

The commonly used forms are: (a) Team structure (b) Matrix structure (c) Project structure

These are discussed under:

1. **Team Structures:** In this structure organisations are made up of teams and each team works towards a common goal. They are flexible and less hierarchical and teams can incorporate their own way of working. Some teams may have team leader who is in charge of their group.

2. **Matrix Structure:** A matrix structure is an effective system for project based organizations. Under this structure different specialists from different functional department work on one or more project. Each specific project is assigned a project manager and is allocated all the necessary resources required to fulfil the project objectives. In this type of structure, there are two mangers, the project manager and the functional manager.

3. **Network Structures:** A networking organisation is one that is created around a central organisation (called the hub organisation) that has association and understanding with some other organisations, to perform functions like designing, manufacturing, marketing etc. for the central organisation, on a contractual basis.

7.12 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 aperson has to do, from whom he has to take orders and what rules, policies and work procedures he has to follow. 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, refer to relationships between individuals in the organisation based on personal attitudes, likes and dislikes. They originate to meet their social and emotional needs and develop spontaneously. They represent natural grouping of people in work situations and are supplementary to formal organisations as they serve the needs not satisfied by formal organisations. The formal organisation does not provide any 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 with respect to their origin, purpose, structure, authority, channels of communication and behaviour of members.

7.13 DIFFERENCE BETWEEN FORMAL AND INFORMAL ORGANISATIONS

S. No	Basis	Formal organisation	Informal organisations
1.	**Meaning**	Established pattern of relationships among departments, divisions and individuals to achieve well-defined golas	Relationship between individuals in the organisation based on personal attitudes, likes and dislikes.
2.	Creation	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.
3.	Objective	It is created to get the jobs of an organisation performed in a planned and systematic manner.	It is formed satisfy those needs of members which cannot be satisfies through formal organisation.
4.	Authority	The authority of every employee defined in the organisational structure in accordance with the job position.	The authority of employees arises out of their personal qualities.
5.	Nature	Formal organisation is permanent and stable.	It is of temporary nature and changes from time to time with size and membership.

7.14 DELEGATION OF AUTHORITY

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 subordinates and give them authority to carry out 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 week's 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.

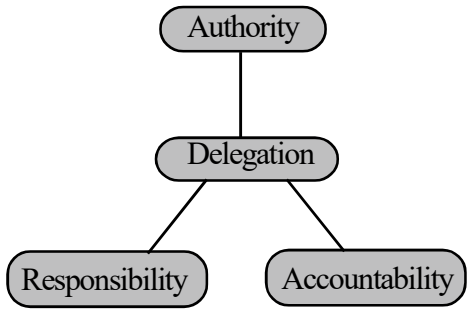


Fig.: 7.4 Divisional Structure

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 on them. 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 use 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.

7.14.1 IMPORTANCE OF DELEGATION

Delegation is considered as one of the most important elements in the process of organisation because:

1. It **reduces the work load** on managers as work is successfully shared by the subordinates;

2. **Improves the managerial effectiveness** because by delegating a good part of work to the subordinate the managers are able to concentrate on important matters;

3. Helps the **subordinates to develop and grow** as they are provided with new responsibilities;

4. The faith and trust displayed in the subordinate builds his **confidence and selfesteem** there by boosting their motivation;

5. It leads to creating a healthy work environment and harmony among the employees. Thus, delegation facilitates **organisational growth.**

7.15 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 levels under a well-considered plan. Take the case of traffic police controlling movement of vehicles on road. The traffic police holds a lower level position in the organisation, yet he has a lot of authority given to him. The seniors 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 focus on policy decisions like product lines to be added, furture investments etc. Decentralisation has a number of benefits as given below:

1. It reduces the workload of the top level management.

2. It motivates the employees and gives them more autonomy.

3. It promotes initiative and creativity.

4. It also helps employees to take quick and appropriate decisions.

5. In this process, the top management is freed from the routine jobs and it enables them to concentrate on crucial areas and thus plan for growth.

7.15.1 DISTINCTION BETWEEN DELEGATION AND DECENTRALISATION

S. No.	BASIS	DELEGATION	DECENTRALISATION
1.	**Meaning**	Delegation refers to the process of entrustment of a part of work or responsibility and authority to another and the creation of accountability for performance.	Decentralisation refers to a systematic effort to delegate authority at all levels of management and in all departments.
2.	**Nature**	It is a compulsory act as no individual can perform the entire task on his own.	It is an optional policy as it is decided by the top management.
3.	**Purpose**	It is undertaken to lessen the burden of the managers.	It is undertaken to increase the role of subordinates in the organisation by giving them more authority.
4.	**Scope**	Delegation is narrow in scope as it is limited to superiors and their immediate subordinates.	Decentralisation is wide in scope as it involves all the levels of the management.
5.	**Responsibility**	The responsibility is not shared and remains with the superior.	Responsibility is also shared and is delegated to the subordinates.
6.	**Authority**	Authority is granted by the superior to the subordinate	It is a systematic act which takes place at all levels and all functions.

TERMINAL EXERCISE

Very Short Answer 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 Questions

1. State the different steps of planning process.
2. Differentiate between external and internal planning premises.
3. What is functional authority? How is it different from line authority?
4. State the different elements of delegation.
5. Mention the different steps of organising.
6. Why should a rule be considered as a plan?
7. Write a short on 'Procedure'.

Long Answer Questions

1. Explain the features of planning.
2. What is meant by planning? Describe any four-points of importance of planning.
3. What is organising? Describe the steps in the organising process.
4. Explain the meaning of formal and informal organisations. What are the differences between these two?
5. If a person is responsible for supervising employees, why must that person have authority?
6. Write short s on Rules, Procedures, Budget and Programme.
7. Explain 'Rules' and 'Methods' as types of plan. Differentiate between the two.
8. Explain the limitations of planning.

8. STAFFING AND DIRECTING

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 suitable persons and employ them. Thus the growth of an organisation requires talented and hardworking people who are provided by the Staffing function of the management. Further, these people need to be guided, inspired, motivated towards the desired goals and this is ensured by the next function of management i.e. directing. In this lesson, you will learn in detail about the staffing and directing functions 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 along with the elements of directing.

LEARNING OUTCOMES

- explains the role of staffing in a business organisation to understand its distinguishing process;
- examines how human resource is recruited and selected; and
- describes the process adopted by human resource to direct and supervise manpower.

8.1 MEANING OF STAFFING

After the function of planning and organising, the next step is to fill up the job positions in the organisation structure and this is done through the managerial function of 'staffing'. Staffing refers to 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. In other words, staffing is that part of the process of management which is concerned with getting , utilising and maintaining a satisfactory and satisfied work force. It is 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 and additions of new activities and departments. Another important aspect of staffing function is that it 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.

8.2 IMPORTANCE OF STAFFING

All of us know that organisations are made up of and function through people. For example, if you do not have good salesmen 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 with 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 performance levels of the workers can be further 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 advancement.

(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 are 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.

8.3 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 step in the staffing process is recruitment and selection i.e., finding out the available manpower from internal and external sources and appoint them. 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;

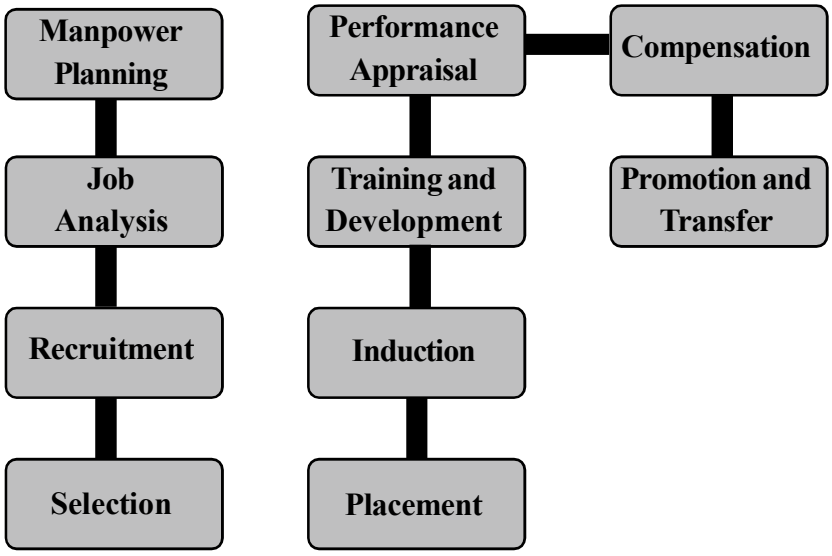


Fig. 8.1 Steps in staffing proess

Let us now discuss these aspects briefly to gain more clarity

8.3.1 MANPOWER PLANNING

Manpower planning is a future oriented activity and involves 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 kind of staff (quality) as well as the number of staff (quantity) needed for the organisation. The focus of the manpower planning is to get the right number of qualified people at the right time.

8.3.2 JOB ANALYSIS

A job analysis is a process of systematically collecting information relating to all the aspects of a job. It is a task that compiles and analyses data relating to skills, abilities, knowledge, duties, responsibilities, relationships of a specific job. Job analysis helps in developing:

i. Job description- statement of duties and responsibilities and tasks involved for each job.

ii. Job specification- statement of the qualifications, skills and abilities required for performing the job.

8.3.3 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 in joining 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 person, 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 qualifications 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 from where the suitable candidates can be hired. 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. The internal sources of recruitment include transfers and promotions.

(i) Transfer means shifting of an employee from one job to another without changing the responsibilities and salary and;

(ii) Promotion involves shifting or transferring employees to a higher job.

The advantage of internal recruitment is that:

1. 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.

2. Employees also feel happy as their work performance is recognised by the management through promotion.

However, there is one major drawback of recruitment through internal sources i.e., the organisation is deprived of the benefit of inducting fresh blood into its system.

(B) External Sources : All vacancies cannot be filled up from within the organisation. Existing employees may lack the required skill, initiative and qualifications 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 :

(i) 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.

(ii) 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 their details to the employer for consideration.

(iii) Educational Institutions: Now-a-days, companies/big organisations maintain a close liaison with the universities, vocational institutes and management institutes 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.

(iv) **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.

(v) **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 and may be considered for regular employment at a later stage.

(vi) **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.

(vii) **Placement 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.

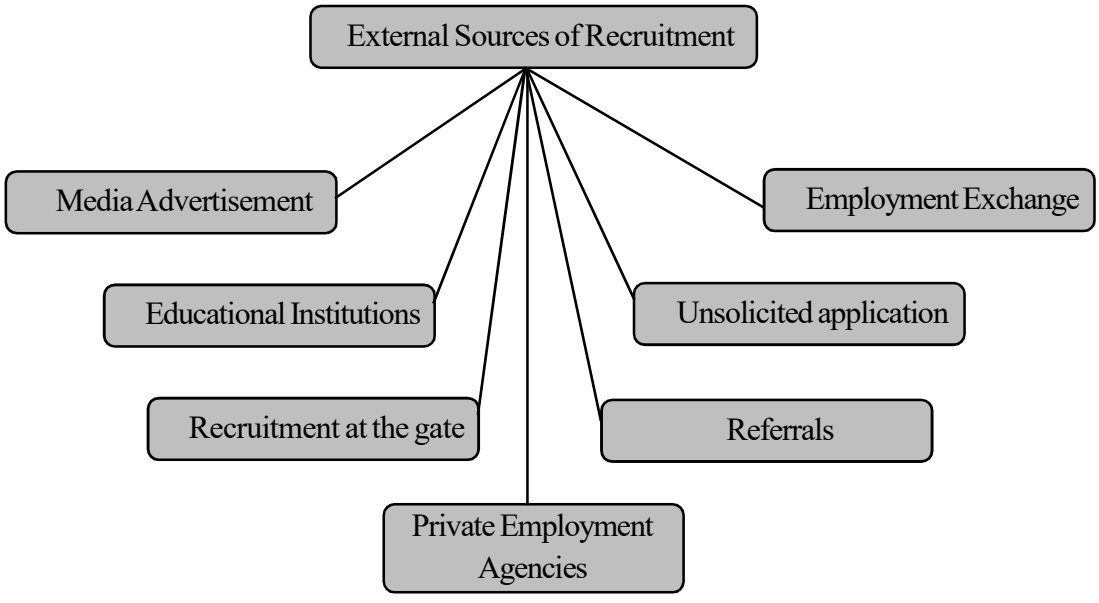


Fig.: 8.2 External Sources of Recruitment

8.3.3.1 RECENT TRENDS IN RECRUITMENT

(i) **E-Recruitment:** Websites are the modern sources of recruitment where the job vacancies are advertised through worldwide web (www). This has an advantage of reducing the cost per candidate, saves time, is convenient and a faster way, for example naukri.com, job search.com, monster.com etc.

(ii) **Outsourcing:** Recruitment Process Outsourcing is "a form of business process outsourcing (BPO)" where an employer transfers all or part of its recruitment processes to an external service provider.

(iii) **Internships:** These provide employment to fresh graduates especially in technical areas to work as summer interns and later on they may be offered regular jobs on completion of their internship training.

(iv) **Walk-in-interview:** Under this method the employer can insert a 'Walk in' or 'Talk in' advertisement in a leading newspaper or online . Those who walk in (i.e come personally) or

talk in (i.e contact over phone) are further asked to give their details for the job vacancy. This serves as a good source of recruitment when the vacancies arise all of a sudden and need to be filled up immediately.

8.3.4 SELECTION

When an adequate number of application/names of interested candidates have been collected through the recruitment exercise, 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. These steps are as follows:

Let us discuss all the steps in brief.

(a) **Screening or 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 to ascertain whether or not the minimum eligibility conditions in respect of age, experience, qualifications and skills are fulfilled by the candidates.

(b) **Holding Selections 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 beconsidered. The nature of test depends upon the nature of the job involved. For clerical jobs, for example, an intelligence and aptitude test may be arranged which may include test of general knowledge, test of quantitative problems, and test of reasoning power and vocabulary. For industrial workers and technical hands, performance tests may be organised. 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) **Conducting 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 the 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 candidate's suitability.

(d) **Checking of References:** In addition to the requisite educational qualification, kill 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 a 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 or not. 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 the candidate 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 the 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 organization.

Probation period: In most of the organisations the candidates are not initially appointed on permanent basis because it is considered better to try them out for a few months on the job itself. This period of service is known as the period of probation.

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 recruitment and selection

S.No.	BASIS	RECRUITMENT	SELECTION
1.	Meaning	Recruitment is the process of finding and attracting suitable applicants for employment.	Selection is the process of choosing the most suitable person from among the list of interested candidate.
2.	Objective	The objective is to encourage large number of potential candidates to apply for the job.	The objective of selection is to reject the unsuitable candidates.
3.	Nature	It is a positive function as it attracts candidates to the organisation.	It is a negative function as it rejects candidates at every step.
4.	Process	It is a simple process.	It is a complicated process as it involves a number of steps.

8.3.5 PLACEMENT

If the selected candidate decides to join the organisation, he/she has to report to the concerned authority and formally join the organisation by giving his consent in writing. Then he/she is placed to perform a specific job. Thus, **placement refers to determination and assignment of job to the selected candidate.** It involves Recruitment is the process of finding and attracting suitable applicants for employment. The objective is to encourage arge number of potential candidates to apply for the job. It is a positive function as it attracts candidates to the organisation. It is a simple process. Selection is the process of choosing the most suitable person from among the list of interested candidates The objective of selection is to reject the unsuitable candidates. It is a negative function as it rejects candidates at every step. It is a complicated process as it involves a number of steps. occupying the position or post for which the candidate has been selected. It includes the initial assignment of the new employee and transfer and promotion of the existing employees. It also serves a useful purpose on many occasions like selection of employees for training, promotion, increments etc.

8.3.6 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. of the organization. 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.

8.3.7 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 a 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 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 f an individual in all areas. Development helps the 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 operations and skill requirements 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. It also helps them in promotion and improves their attitudes and confidence levels.

Difference between Training and Development

S.No.	BASIS	TRAINING	DEVELOPMENT
1.	**Nature**	Training is concerned with teaching technical skills only.	Development is concerned in teaching technical, human and conceptual skill.
2.	**Suitability**	It is suitable for technical staff	It is suitable for managerial staff.
3.	**Time Duration**	It is a short term process.	It is a long term process.
4.	**Orientation**	Training is job-oriented.	Development is career-oriented.
5.	**Scope of Learning**	It teaches technical skills and is meant for non-managerial personnel.	It teaches concepts and human skills and is meant for managerial personnel.

Importance of Training and Development :

Training and Development is beneficial for both the organisation and the employees as it not only increases an employee's productivity and facilitates growth, but also leads the organisation towards success.

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. Develops positive attitude in the mind of workers and motivates the workforce to take on new ventures.
5. Reduce labour turnover and absenteeism.
6. Reduced accidents as workers are trained in handling machines and aware of better safety mechanisms.
7. Trained workers will adopt fast to the environmental changes compared to untrained workers.

Benefits of Training to the Employee:

1. Improved skills acquired from training bring better career options for workers.
2. Better performance by the workers help him to earn more.
3. Increased job capacity to adopt to new methods and technologies.
4. Trained worker will have better awareness of handling problems and they will be capable of dealing with complex jobs.with complex jobs.
5. Increased job satisfaction increases the moral of the 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, (2) Off-the-Job methods.

1. On-the-Job Methods : In these methods, the employees learn about their jobs while doing the work duly assisted by their supervisors or seniors. These methods encourage self-learning through practice. Job instruction or coaching, and job rotation, learning while working as an assistant to a senior, under study 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 the 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.

8.3.8 PERFORMANCE APPRAISAL

People differ in their abilities and talents and it is necessary for the management to know these differences so that they can be rewarded appropriately. Performance appraisal means judging the performance of employees. Performance appraisal means evaluating an employee's current and/or past performance as against certain pre-determined standards. 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. 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.

8.3.9 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 on 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 motivate them to work hard.

8.3.10 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.

8.4 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 cannot 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 ensuring that they do it in the best possible manner. Directing function involves the following:

- **Issuing instructions** and orders to subordinates to carryout their assignments as scheduled;
- **Supervising** the activities of employees;
- **Inspiring** them to meet the mangers' expectations and contribute towards the achievement of organisational objectives; and
- Providing **leadership.** Managers plan and take decisions.

Directing function is said to be the heart of management as all other functions of planning, organising, staffing cannot be performed until directing takes place.

Thus, directing is 'management in action'. It is through the exercise of this function that managers get things done through people.

8.5 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.

  It helps to integrate the various activities and also the individual goals with organisational goals.
- Directing involves leadership that essentially helps in creating appropriate work environment and build up team spirit.

8.6 ELEMENTS OF DIRECTING

Communication, Supervision, Motivation and Leadershipare the four essential elements of directing. In the subsequent sections we shall discuss about the nature and significance of each of these components.

8.6.1 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). It is the process of exchange of ideas, opinions, facts, views and information. The purpose of communication in organisations is to convey orders, instructions, or information so as to bring desired changes in the performance and or the attitude of employees. In an organisation, supervisors transmit information to subordinates. Proper communication results in clarity and securing the cooperation of subordinates. Faculty communication may create problems due to misunderstanding between the superior and subordinates. The subordinates must correctly understand the message conveyed to them.

Elements of Communication Process: Communication is a continuous and a two way process.

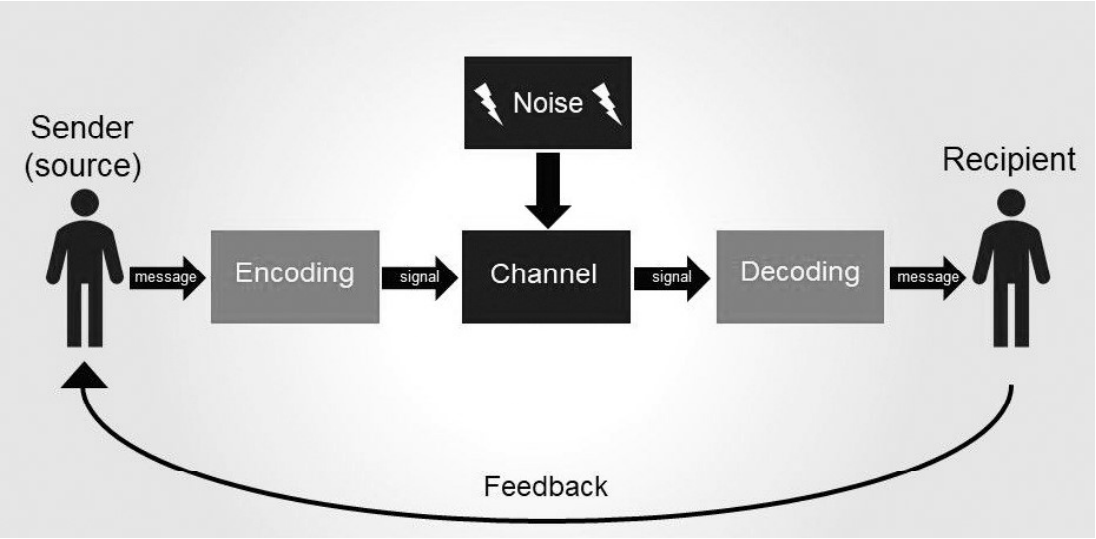


Fig.: 8.3 Communication Process

- 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 and gives a feedback of the same.

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.

Types of Communication

In an organisation communication can take place from a supervisor to the subordinate, from subordinate to the 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
→ Formal	→ Upward	→ i) Verbal
→ Informal	→ Downward	a) Oral b) Written
	→ Horizontal	→ ii) Non-verbal (gestures)
	→ Diagonal	

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 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, communication 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. When communication is made from superiors down the hierarchy it is called a downward communication. For instance, when superiors issue orders and instructions to subordinates, it is known as downward communication. When the General Manager orders supervisors to work overtime, the flow of communication is downward i.e., from top to bottom. Similarly, communication of work assignments, notices, requests for performance, etc. through bulletin boards, memos, reports, speeches, meetings, etc, are all forms of downward communication.

Communication can also be amongst members at the same level in the organisation. For instance, production manager may communicate the production plan to the sales manager. This is known as horizontal flow of communication. Here, the communication is among people of the same rank and status. Such communication facilitates coordination of activities that are interdependent. When communication is made between people who are neither in the same department nor at the same level of organisational hierarchy, it is called diagonal communication. For example, cost accountant may request for reports from sales representatives, not the sales manager, for the purpose of distribution cost analysis. This type of communication takes 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 intercommunication 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 gestural communication.

Barriers to Effective Communication

Barrier means the hindrance that adversely affects 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 and small).

2. **Badly Expressed Message:** Same times the manager may use wrong words.The manager may omit needed words unintentionally.

3. **Faulty Translation:**A manager receives information from his superior and transfers it to his subordinates. A 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. **Unclarified Assumptions:** Sometimes a sender takes it for granted that the receiver knows same basic things. So the sender may communicate 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 of the receiver or the sender.

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 a barrier 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 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 centralized organisation, all important information is retained at the level of top 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 distorted before it reaches the receiver.

D. Personal Barriers

1. **Fear of Challenge of Authority :** Superiors try to conceal information if they fear losing their authority over the subordinates.

2. **Lack of Confidence in Subordinates :** Top level officers do not have confidence in 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 the reason why their suggestions are not given any importance.

How to Overcome the Barriers

Most of the barriers can be removed and the communication can be made more meaningful and effective if the following points are considered by the manager:

1. **Consult Others before Communicating:** If the subordinates are allowed to participate in the development of the message to be communicated, they will accept it and will have a commitment to implement it. Therefore, it is better to involve others in developing the message.

2. **Communicate Caccording to the Needs of the Receiver :** The sender of the 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. The communicator should be clear about 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 communicate 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 in removing misunderstanding of instructions, if any.

7. **Use of Informal Channels:** A manager must make use of the grapevine to support the formal channels of communication.

8.6.2 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.

A Supervisor, thus, performs the following functions:

- clarifies orders and instructions issued to subordinates and ensures that they 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.

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 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 grievances, feelings, demands etc. of the workers to the higher level management.

2. **Creating Ideal Atmosphere :** Being an important link between the operations 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 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 steady 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 objective to further improve their performance in the 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.

8.6.3 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 inspires 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.

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 cannot 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, materials 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.

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 needs 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.

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 the 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 needs 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.

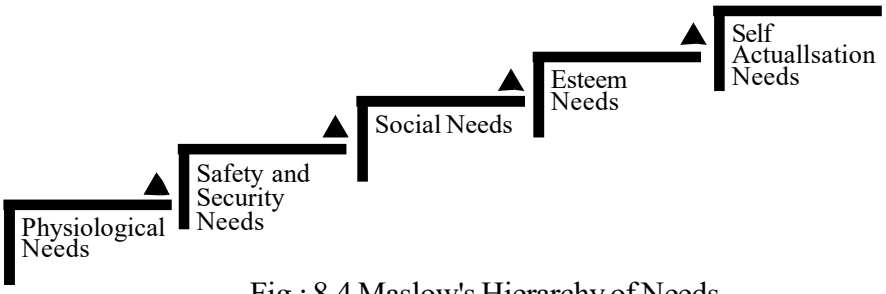


Fig.: 8.4 Maslow's Hierarchy of Needs

Financial and Non- financial incentives: Incentives are the positive motivational influences that help the persons to improve their performance. They can be financial (monetary) incentives and non-financial (non monetary) incentives .

Financial incentives can be in the following forms:

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 can include the following:

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 anorganisation. 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 at a 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 especially when decisions are related to workers.

8.6.4 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 to the fellow workers the benefits of working with the new machines and moulds them to accept the management's decision. Now she is said to be the leader as she 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 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.

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. Thus leadership is important as it provides the following benefits:

- Leadership influences the behavior of people and thus makes them contribute towards the benefit of the organisation.
- 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.

Leadership Qualities

In order to be successful, a leader must possess certain qualities.

1. 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.
2. He must possess initiative, perseverance, be diligent and realistic in his outlook.
3. He must also be able to communicate with his subordinates effectively. Human relation skills area must for any leader.
4. 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.

TERMINAL EXERCISE

Very Short Answer Questions

1. What is meant by manpower planning?
2. Distinguish between job description and job specification.
3. What is meant by 'Inducation'
4. List any four sources of external recruitment.
5. State the meaning of selection.
6. What is meant by Promotion?
7. Name the term used for equipping the workers with the required skill to perform the job.
8. What is meant by directing? Name its different elements.
9. Who is a leader? List any four qualities of a good leader.
10. What is meant by financial incentive? Give any two examples each of financial and non-financial incentives.

Short Answer Questions

1. Define the term 'Recruitment'. State the various advantages of internal recruitment.
2. What is meant by development? Differentiate between training and development.
3. Training is beneficial to the organisation'. Comment.
4. Explain in brief the importance of directing.
5. State the different types of communication on the basis of direction.
6. Explain the functions of a supervisor.
7. Describe the importance of motivation.
8. Distinguish between selection and recruiment.
9. What are semantic barriers to communication?
10. Explain in brief any three types of financial incentives.

Long Answer Questions

1. Explain the role of Employment Exchange as source of external recruitment.
2. Briefly describe the various steps involved in the selection process.

3. Distinguish between selection and recruitment.

4. What is meant by training? Explain the different methods of training.

5. Describe the essential elements of the managerial function of directing.

6. What is communication? Explain how communication is an important element of directing function of management.

7. What is meant by the term supervision in management? Explain briefly the functions of a supervisor.

8. Explain the term leadership and state the qualities of a good leader.

9. "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.

10. What are the functions of a supervisor? Explain briefly.

11. Discuss in detail Maslow's need hierarchy theory of motivation.

12. What is meant by 'Monetary Incentives'? State any five types of monetary incentives. Which contribute to the performance of employees?

13. Explain briefly non-financial incentives used to motivate employees of a company.

14. There are some barriers in communication which are concerned with organisational structure and rules and regulations. State any three such barriers.

9. 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 coordinating and controlling functions in detail. 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 a need to ensure that activities of such divisions, sub-divisions and departments are harmonised and duly monitored so that the performance of the organisation conforms 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.

LEARNING OUTCOMES

- discusses the importance of co-ordination as a functional area of management;
- describes the process of controlling human recourses; and
- examines the importance of controlling human resource in a business organisation.

9.1 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, co-ordination 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 goals can be duly achieved. Thus, co-ordination 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, "Co-ordination 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."

9.2 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 forms 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 to problems of supervision and communication. Hence, co-ordinating 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 product lines. 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 co-ordination more difficult as well as important.

In view of the importance of co-ordination in an organisation, it is 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, and maintenance of harmonious relationship between different groups and ensuring economy and efficiency in the organisation.

9.3 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 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 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."

Planning and controlling are closely related and depend on each other. Controlling depends on 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 d 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 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

(a) knowing the nature, quantum and time frame of the work;

(b) comparing the performance with the plan;

(c) analysing deviation, if any;

(d) taking corrective steps; and

(e) suggesting revision of plans, if necessary.

9.4 CHARACTERISTICS OF CONTROL

The following are the basic characteristics of control.

1. Planning is the Basis of Control: Control is said to be checking performance as per what has been planned. So planning precedes controlling and sets the standards and targets of performance.

2. Control is a Continuous Process: It is an ongoing and dynamic function of management. It involves a continuous review of performance and is not a onetime 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 in 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.

9.5 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 like, '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 a 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.

9.6 PROCESS OF CONTROL

The process of control consists of various steps. Look at the following example: Ram is employed in a garment 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.

1. **Establishment of Standards:** Setting standards 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 too 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 costs. 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.

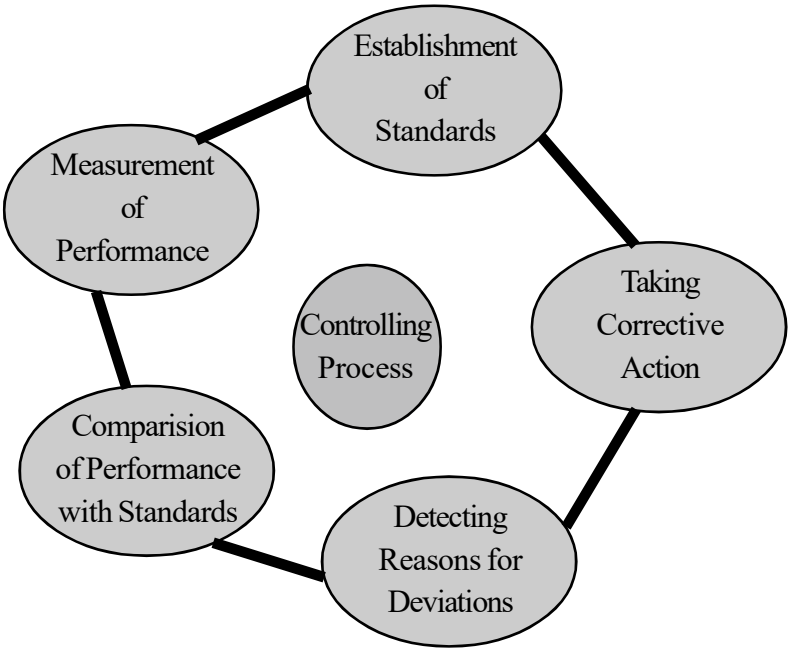


Fig.: 9.1Controlling Process

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 causes, 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.

TERMINAL EXERCISE

Very Short Answer 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 so as to why we need control?
5. What do you mean by controlling?

Short Answer Questions

1. What is meant by control?
2. List the steps in the process of control.
3. Explain briefly why coordination is called essence of management?
4. Planning and control are inseparable. Discuss in brief.
5. What should a manager do when there is difference between actual and standard performance.
6. 'There is a close and reciprocal relationship between planning and controlling'. Comment.

Long Answer Questions

1. Explain various steps of the process of control.
2. Co-ordination is needed at all levels and in all functional areas of management. Comment.
3. Describe the characteristics of control.
4. State the meaning of controlling. Why is it required that every organisation must follow a certain control system in its activities.
5. Describe in detail the relation between controlling and planning.

Module 3
Business Finance

10. FINANCIAL PLANNING AND MANAGEMENT

Finance is the life blood of industry and commerce. Smooth and economic functioningof a business is not possible without the availability of adequate finance. No business activity can ever be pursued without financial support. Financial viability is perhaps the control theme of any business proposition. It is very difficult to conceive of a policy decision which will not have financial repercussions. Thus, effective management of finance is essential for the survival, growth and sound health of any business organisation. Thus, in the absence of efficient financial management, several undesirable results are bound to follow. The absence of sound financial management during production and sales leads to an uneconomic use of funds and will ruin the fortunes of a company. So a well-informed and competent financial management is an absolute necessity for industrial development of the country.

LEARNING OUTCOMES

- explains different financial decisions taken by a finance manager;
- describes objectives of financial management ;
- identifies the basic long term and short term funds requirement ; and
- discussies the effects on business by leveraging on profits.

10.1 MEANING OF FINANCIAL MANAGEMENT

Financial management is concerned mainly with the procurement of funds in an economic and prudent manner and deploying these funds in most profitable way in a given risk situation, planning future operations and controlling current and future performanceand development through different tools.In other words, financial management is basically concerned with mainly three decisions, namely, investment decision, financing decision and dividend decision.

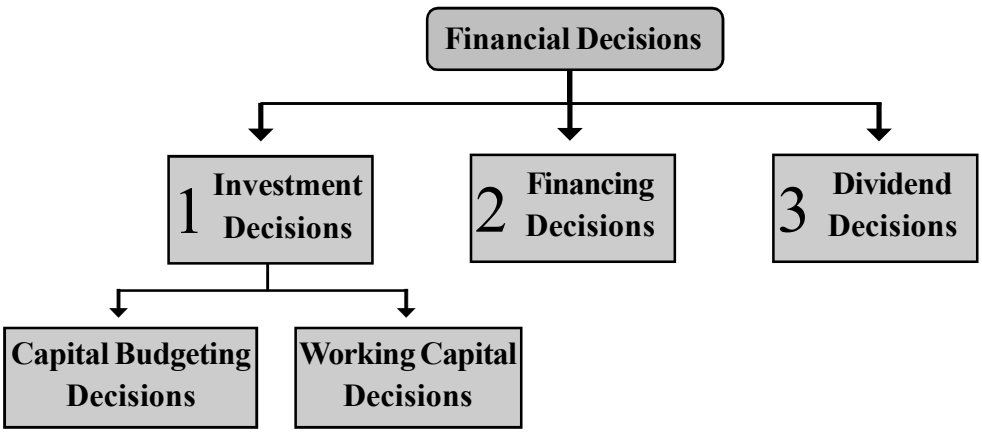


Fig.: 10.1 Financial Decisions

10.1.1 INVESTMENT DECISION

This decision involves careful selection of viable and productive assets in which funds have to be invested. It comprises:

(a) Decision relating to long term investment in fixed assets [called capital budgeting decision];

(b) Decision relating to short term investment in current assets [called working capital decision]

There are other two decisions also:

(c) Decision relating to portfolio investment in securities; and

(d) Decision relating to merger and take-over investment

Investment decisions are influenced by cash flow by giving due care to time, value of money, risk involved, technological changes etc.To find out the viability of each capital expenditure decision,Capital budgeting, Cost-Volume-Profit analyses are the techniques generally used for the process of investment decisions.

10.1.2 FINANCING DECISION

Financing decision is concerned with the procurement of funds, in an economic and prudent manner after judicious identification of timing and quantum of various sources of funds to be raised. Funds are available through primary market, financial institution *not to be considered in this unit and through the commercial banks. The cost associated with each of the instrument or source of funds is different. The overall cost of capital must be kept at minimum. Proper Debt/Equity ratio should be maintained to maximize the returns to the shareholders. This decision will be made by considering the different factors Viz., inflation, size of the organisation, Government policies, etc. In this way, decision criteria in financing decisions are:

(a) What is the overall cost of capital which is to be raised? e.g.(i) cost of equity (ii) cost of retained earnings (iii) Cost of preference share (iv) cost of debenture (v) cost of other long term and short term debts (vi) Tax advantages (vii) cost of issue of instrument.

(b) What is the appropriate time of raising funds?

(c) Should the enterprise make underwriting arrangements? If yes, on what terms?

(d) What is the best mix (capital structure) of different instruments?

(e) Statutory provisions in connection with debt and equity.

(f) Threat of losing ownership of the company by take-over threat.

(g) Image of the company in the market.

(h) Liquidity of instruments

(i) How much fund is required?

(j) Chasing spontaneous, which is cost free, source of finance (trade creditors etc.) to finance inventories.

10.1.3 DIVIDEND DECISION

Dividend decision is concerned with taking decision with regards to the net profit distribution which is related either to pay dividend to shareholders or to retain in the business.Thus, Net profits are generally divided into two:

(a) Return to the Shareholders : Amount of Dividend and the rate of dividend to be decided.

(b) Retained profits : Amount of retained profits has to be finalized which wll depend upon expansion and diversification plans of the enterprise. Hence, the objective of a dividend decision should be to maximize a shareholders' return so that the value of his investment is maximized. Equity Shareholders' return consists of two components viz, dividends and capital gains.

10.2 OBJECTIVES OF FINANCIAL MANAGEMENT

The key objectives of financial management are:

Profit Maximization: A business firm is an organization established for the primarypurpose of making profit for its owner. Generally, profit maximization is regarded as the prime objective of the business. Profit as a means for enabling the company to grow without unduly hurting various interests will be acceptable. But profit alone as a goal may prove to be harmful to the company as a whole. It has been rejected as an operational criterion for maximizing the owners' economic welfare and as it fails to provide an operationally feasible measure for ranking alternative courses of action in terms of their economic efficiency. It suffers from the following limitations:

(a) It is vague

(b) It ignores the timing of returns

(c) It ignores risk

Wealth Maximization and Value Maximization: It is commonly understood that the basic objective of a business is to maximize wealth which lies in maximization of the value of shares held by owners as they are the contributors to initial capital. For achieving this objective, the financial manager allocates the funds in assets and controls their use taking time, value of time into consideration. A business should aim at maximization of wealth and it depends on two factors namely, the profit earned per share and capitalization rate.

10.3 FINANCIAL PLANNING

To understand what is financial planning, first you imagine that you have no money at present but willing to earn some income, what will you do? Certainly, you will go searching and evaluating the

different available safe, secure alternative investment opportunities with growth prospective from where you can earn an income or return which is higher than cost.Then, at the time you will also try to find out from where you can raise or manage some money or funds,as you have no money, at lowest cost for investment purposes.This is called financial planning. Likewise, in business, financial planning involves investment and financing choice. Thus, financial planning deals with framing of financial policies in relation to procurement of funds, investment of these funds and administration of funds of a business enterprise to achieve its objectives. Thus, financial planning involves the following facets:

(a) Estimating the current financial condition of the firm.

(b) Analyzing the future growth prospects and options.

(c) Appraising the investment options to achieve the predetermined growth objective.

(d) Projecting the future growth and profitability.

(e) Estimating funds requirement and considering alternative financing options.

(f) Comparing and choosing from alternative growth plans and financing options.

(g) Consequences of financial plans.

10.3.1 ESSENTIALS OF A SOUND FINANCIAL PLAN

Financial planning is the process of identifying a firm's investment and financing needs,given its growth objectives. It is a trade-off between various investment options and financing option. Thus, while preparing a financial plan for any business unit, the following aspects should be kept in mind so as to ensure the success of such an exercise in meeting the organizational 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 financial market. But it is considered better to confine to owned funds (equity shares) and simple fixed interest-bearing finance (debentures and loans).

(b) **It must take a long-term view:** While estimating the capital needs of a business and raising the required funds, a long-term view is to be taken into consideration which means that besides the need of 'today', the capital requirements of 'tomorrow' should also be kept in view. 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:** It is absolutely necessary that the financial plan must be capable of being adjusted and revised without any difficulty and delay so as to meet the future requirements of funds in changed business environment. Because no one may 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.

(d) **It must ensure optimal use of funds:** Whatever funds a business is raising, it has some cost which a firm has to pay to the provider of capital. Hence, capital should not be only adequate

but should also be employed in a productive way and there should be proper balance between fixed capital and working capital. There should not be idle funds otherwise the profitability will decline.

(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 capital raised should be reasonable. The financial plan should provide for optimal capital structure (combination of debt and equity) which minimises the cost of capital and increases earnings per share, otherwise it will adversely affect the return on shareholders' funds.

(f) Adequate liquidity must be ensured: Liquidity refers closeness to cash which means the state of readiness to meet out the obligations of the firm as and when it becomes due during the course of the business. 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 also kept in marketable securities so that it can be readily converted into cash to meet all possible eventualities.

10.3.2 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.
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.

10.4 CONCEPT OF CAPITAL STRUCTURE

Broadly speaking, there are two forms of capital:

1. Equity Capital
2. Debt Capital.

A) Equity Capital: This refers to money put up in the business and owned by the shareholders (owners). It is costliest source of finance.Typically, equity consists of two types:

1) Contributed capital, which is the capital that was originally invested in the business in exchange for equity share capital and preference share capital; and

2) Retained earnings consist of share premium + free reserve + surplus profits + discretionary provisions for contingency + development rebate reserve. It represents profits not distributed as dividend from past years that have been kept by the company and to be used for growth, expansion or acquisitions of the business.

B) Debt Capital: Debt consists of all borrowings from government, semigovernment + statutory corporations and other agencies + term loans from banks and financial institutions + debenture issues + all deferred payment liabilities. Short-term debt such as working capital requirements is also considered to be part of the capital structure. The capital structure of a firm refers as a choice of that combination of debt and equity, which is used for financing the operations of business and to maximize the market value of the shares of the firm.

10.4.1 PATTERN OF CAPITAL STRUCTURE

Thus, capital structure refers to the proportions or combinations of equity share capital, preference share capital, debentures, long-term loans, retained earnings and other long-term sources of funds in the total amount of capital which a firm should raise to run its business. When a company is analyzing what capital structure to adopt it can opt for:

(i) Capital structure with equity shares only

(ii) Capital structure with equity and preference shares

(iii) Capital structure with equity shares and debentures

(iv) Capital structure with equity, preference shares and debentures

10.4.2 COST AND RISK OF DEBT AND EQUITY

Debt and equity differ in cost and risk. Debt involves less cost as interest paid on debt is treated as a revenue expense and is subject to tax-shield, but it is risky because payment of regular interest on debt is a legal obligation for the business. In case the company fails to pay debt, debenture holders can claim over the assets of the company and if company fails to honour interest payment, it can even go to liquidation and stage of insolvency.

Equity securities are safe securities from company's point of view as company has no legal obligation to pay dividend to equity shareholders even if company is running on profit or loss but equity are expensive as payment of dividend is not subject to taxshield and their expectation of return is high as well as the company has no legal obligation to pay their capital contribution during the life of the company as they are owners. Equity shareholders will only get their capital after the winding-up of the company as a last piece of the cake.

10.4.3 DIFFERENCE BETWEEN CAPITAL STRUCTURE AND FINANCIAL STRUCTURE

1. Capital structure includes non-current liabilities whereas financial structure includes non-current liabilities and current liabilities.

2. Capital Structure consists of shareholders' fund and long-term debt whereas financial structure consists of Shareholders fund, long-term debt and current liabilities.

3. Capital structure refers to the proportion of long-term debt and equity in the total capital of a company whereas financial structure refers to the net worth or shareholders' fund or owners' equity and all liabilities i.e., long-term and short term.

4. Capital structure of a company is a part of its financial structure whereas financial structure comprises capital structure and current liabilities.

5. Capital structure does not include short-term or current liabilities whereas financial structure is the sum of long-term as well as short-term liabilities.

10.4.4 DETERMINANTS OF CAPITAL STRUCTURE

The factors which influence the decision of capital structure are:

1. **Cash Flow Position:** What should be the mix of debt and equity in the capital structure of a company depends upon its ability to generate enough cash inflows because the company is under legal obligation to pay a fixed rate of interest to debenture holders, dividend to preference shares and principal and interest amount on loan.

2. **Return on Investment:** Return on investment is another crucial factor which helps in deciding the capital structure. If the return on investment is more than rate of interest, company must prefer debt in its capital structure. Whereas, if return on investment is less than rate of return to be paid on debt, then company should avoid debt and rely on equity capital.

3. **Tax Rate:** High tax rate makes debt cheaper as interest paid to provider of debt capital is subject to tax-shield before calculating tax liability whereas company has to pay dividend distribution tax on dividend paid to shareholders. So high rate of tax means it will prefer debt whereas at low tax rate means equity in capital structure.

4. **Cost of Financing:** If a company can manage to borrow funds at low rate of interest, it will prefer more debt as compared to equity. On the other hand, equity shareholders expect a high return on their investment i.e., earnings per share. If by the use of debt, EPS is increasing, then company can include debt in capital structure but when EPS starts decreasing with the inclusion debt then company must depend upon equity shareholder or such combination of debt and equity at which EPS is the highest.

5. **Floatation Costs:** Floatation cost is the cost incurred of the issue of shares or debentures. These costs include the cost of advertisement, underwriting, brokerage, agreement with banks and statutory fees etc. which cannot be ignored. There is less cost involved in procuring capital by loans from financial institutions as compared to public issues.

6. **Risk Consideration:** If a company's business risk is low, then it can raise more capital by issue of debt securities whereas at the time of high business risk, it should depend upon equity.

7. **Flexibility:** To maintain flexibility of raising funds, it must have some scope of borrowing power to take care of unforeseen circumstances because excess of debt may restrict the firm's capacity to borrow further.

8. **Control:** The total control of the company lies in the hand of equity shareholders as they are the owners. The authority to manage the affairs of the company rests on Board of Directors. The debenture holders have no say in the management and preference shareholders have limited right to vote in the annual general meeting.

9. **Interest Coverage Ratio:** High interest coverage ratio means the company can have more of borrowed fund securities whereas lower interest coverage ratio means less borrowed fund securities.

10. **Debt Service Coverage Ratio:** If debt service coverage ratio is high, then company can have more debt in capital structure as it indicates ability of the company to repay its debt but if debt service coverage ratio is less, it indicates that company must avoid debt and depend upon equity capital only.

11. **Regulatory Framework:** A company issues shares and debentures within the SEBI guidelines and takes loans. If the monetary policies are more flexible, then they may go for more of loans whereas if SEBI guidelines are easy, then company may prefer issue of financial assets for additional capital.

12. **Stock Market Condition:** Stock market works under two conditions i.e., Boom and Recession condition which affect the capital structure especially when company is planning to raise additional capital as investors may be more careful in their dealings.During the period of boom, business is flourishing and investors dare to take risks and prefer to invest in equity shares to earn more return in the form of dividend and capital appreciation whereas in recession, the stock market business is slow and investors are shaky to take risks. Hence, it is advisable to issue fixed interest bearing securities as these are less risky and ensure fixed payment and regular payment of interest.

10.5 LEVERAGE

You often hear your friends and co-worker say that they are overburdened with work to achieve the sales target. Why does it happen? It happens because of the excessive sales target given to the sales personnel by the sales manager who knows the leverage of its company through which they can minimize risk of incurring loss and losing market share. Hence, knowledge of business leverage of its own company and competitors' firm will provide opportunities to your company to take a business lead while making a decision about how much to generate sales revenue and how much fund is required.

The word 'leverage' has been derived from the word 'lever' which refers to a device through which you can lift more weight with minimum efforts.

Like-wise in business, leverage (sometimes referred to as gearing) refers to the use of a significant amount of debt and/or credit to purchase an asset, operate a company, acquire another company, etc.

with the expectation that the after-tax profit to equity holders from the transaction will exceed the borrowing cost which means increased earnings per share.Leverage refers to the capacity of a firm to employ more debt in the capital structure of the firm to maximize the EPS and to enhance returns to the owner as the cost of obtaining debt is cheap as compared to equity and minimize the cost of capital. That's why every firm tries to minimize cost of capital by incorporating more and more debt in its capital structure.

10.5.1 TYPES OF LEVERAGE

It can be classified into three categories:

(a) **Financial Leverage:** If you can envision a balance sheet of a company, financial leverage refers to the left-hand side of the balance sheet. Financial leverage refers to how the firm will pay for it or how the operation will be financed.

Financial Leverage: refers to the amount of debt in the capital structure of the business firm.This measures the financial risk which arises due to high charge of interest due to excessive use of debt component.It is the company's ability to use fixed financial changes to magnify the effect of changes in EBIT on the company's EPS.A high financial leverage indicates a higher percentage of debt in the capital structure. It magnifies the returns from our debt financing.

Financial Leverage= Earnings before interest and tax (EBIT)/ earnings before taxEBIT

(b) **Operating Leverage:** There are essentially two types of costs in a company's cost structure - fixed costs and variable costs. Operating leverage is the ratio of fixed costs to variable costs. If a business firm has a lot of fixed costs as compared to variable costs, then the firm is said to expose to operating leverage which measures the business risk or operating risk, i.e., variability of EBIT due to fluctuation in sales revenue. It means that if a firm has high operating leverage, a small change in sales volume results in a large change in Earnings before Interest and Tax and Return on Invested Capital.It magnifies the returns from our plant and equipment or fixed assets.

Operating Leverage= Contribution/ Earnings before interest and tax (EBIT)

(c) **Combined Leverage:** It indicates the effect of sales volume on the EPS of the firm.It is the relationship between Contribution and EBT. A higher combined leverage indicates the firm is subject to greater risk which includes both business risk and financial risk. It can be also found out by multiplying operating leverage and financial leverage.

Combined Leverage = Contribution/EBT

or

Combined Leverage = Financial leverage × operating leverage.

Suppose, if operating leverage is 2 and financial leverage is 5, then combined leverage will be 10. It describes that if there is increase of 1% in sales revenue, then earnings before tax or profit before tax will increase by 10% and vice-versa.

10.5.2 THE COMBINED EFFECT OF OPERATING LEVERAGE AND FINANCIAL LEVERAGE

Operating leverage	Financial leverage	Effect
1.	High	High Very risky, high interest outflow
2.	High	Low Sales still unsatisfactory in relation to the fixed costs to be absorbed.
3.	Low	High Ideal situation for profit maximization
4.	Low	Low Management over- cautious or risk averse

10.6 FIXED CAPITAL REQUIREMENT

When you are willing to start any business venture, you will require initially two types of capital; First fixed capital and second working capital. It is to be kept in view thatfixed capital and working capital, both are imperative for a business to run and perpetuate.

Fixed capital is used to acquire non-current assets (fixed assets) which would serve the business for more than one accounting period. Usually it is present in the form of tangible fixed assets like plant and machinery, factory's land and its buildings, company's headquarter and offices, buildings, computing and communication infrastructures and investment in intangible assets like patents, copyrights, goodwill etc.

In simple words, capital invested in the acquisition of fixed assets that are durable in nature and whose benefits can be derived over a long period of time, is called as fixed capital. Investment in fixed assets, as part of the total capital investment, is a promising vehicle, for manufacturing goods which later on can be sold for increasing earnings.

10.6.1 FEATURES OF FIXED CAPITAL

(i) It is a compulsory initial investment made in the business.

(ii) It is a part of total capital invested in the business.

(iii) It has a permanent existence in the business to meet its long-term needs.

(iv) It is used for purchasing tangible physical assets and intangible assets.

(v) It is required for promoting the business, like huge advertising campaign.

(vi) It is also required for expansion, modernisation and diversification of business.

10.6.2 SOURCES OF FIXED CAPITAL OR LONG-TERM FINANCE

1. **Issue of Share:** It is the most important source of fixed capital. Generally, there are two types of shares as has been discussed in previous module.

(a) Equity share and (b) Preference share

2. **Issue of Right Shares:** When a company decides to issue further share, it is first issued to its existing shareholders at a price below the market price. The share capital increases but the number of shareholders does not increase. Generally, rights issue is very economical to collect fixed capital.

3. **Private Placement of Shares:** It means the company sells its shares directly to a small group of investors like bank, financial institutions, mutual funds etc.

4. **Issue of Debentures:** It represents the borrowed capital of the company and holder of debenture gets interest on investment in debenture at predetermined stated rate.

5. **Term Loans:** The company gets term loans from banks and financial institutions like HDFC, ICICI etc by submitting its project analysis report.

6. **Retained Earnings:** It is a part of undistributed profits earned by the company. This saved profit is called as ploughing back of profits.

7. **Lease Financing:** Under lease financing, lessor who is the owner of assets gives the assets on a lease-basis to the lessee and charges lease rent for using that assets.

10.6.3 DETERMINANTS OF FIXED CAPITAL REQUIREMENT

The factors affecting determination of fixed capital requirements of a business are as under:

1. **Nature of Business:** A manufacturing concern needs more fixed capital as compared to a trading concern as the investment in fixed assets is more in case of manufacturing enterprise.

2. **Size of Business:** It can be tiny, small, medium or large scale industries. The parameters while evaluating the size of business are: turnover of business; capital invested; comparing the market share of business etc. Thus, company form of business requires more fixed capital as compared to partnership firms and sole proprietorship.

3. **Scale of Operation:** It signifies the volume in which a production occurs followed by its successful sale in the market. Generally, the scale of operation will be large if availability of fixed capital is more and vice-versa.

4. **Use of Technology:** Companies using labour-intensive techniques require less fixed capital as compared to capital-intensive companies.

5. **Types of Products Manufactured:** Companies manufacturing simple products like paper clips will need less amount of fixed capital as compared to companies manufacturing complex products like industrial products.

6. **Scope of Activities:** If scope of business is vast, it needs higher fixed capital such as manufacturing, processing and assembling as compared to those whose scope is limited requires less amount of fixed capital such as company does only assembling activities.

7. **Method of Acquiring Assets:** If the assets are acquired on a rental or lease direct basis it requires less fixed capital as compared to instalment purchase basis and direct cash purchase basis.

8. **Government Subsidy:** It means financial assistance allocated to needy companies on certain terms and conditions as framed by the government. Generally, companies operating in backward areas get concession or subsidy for purchasing fixed assets (requires less amount of fixed capital) whereas companies operating in developed areas do not get any subsidy even though they need more fixed capital.

10.6.4 DETERMINATION OR ESTIMATING FIXED CAPITAL REQUIREMENT

Estimating the requirement of fixed capital is quite complicated work because it require sa complete knowledge of the fundamentals of finance; market and continuous practice without which one will not succeed in estimating the required amount of fixed capital. The amount invested in fixed assets is termed as fixed capital and in the language off inance it is termed as capital budgeting which involves two most important estimate si.e., cash outflows and cash inflows. When a new asset is to be bought, it is necessary to estimate the costs involved to buy and to put the asset into production. This istermed as cash outflow or to be precise net cash investment. Simultaneously, the annual cash inflows the project will generate after it goes into operation. So, it is necessary to estimate the internal cash inflows, resulting from the production and sale of the out put over the life of the asset. This estimate of cash inflows is called net cash benefits. The following examples will provide you with a blue print in estimating fixed capital requirement.

A- Estimating Fixed Capital Requirement. (Cash Outflows):

	Items	**Amount (₹)**
1.	(a) Estimated price of fixed assets	100
	+(b) Freight charges or carrying cost	5
	+(c) Installation cost	5
	Total of 1. 110	
2.	Add: permanent increase in working capital	20
	Add: Training expenses after adjusting tax rebate, if any	10
	Total of 2	30
3.	Grand Total (1+2)	140
4.	Deduct: Net proceeds from the sale of old fixed assets (salvage value-cost of removal and disposal)	5
5.	Balance (3-4) or Net cash outflows or fixed capital requirement.	135

B- Estimating Net Cash Inflows (from operation to compensate fixed capital)

	Items	Amount (₹)
1.	Income from sales revenue (cash sales plus credit sales assuming it is willfully realized as and when it becomes realizable)	100
2.	Deduct: Cost of goods sold (cash expenses i.e., fixed and variable expenses)	(40)
3.	EBDIT [earnings before depreciation, interest and tax] (1- 2)	60
4.	Now deduct: amount of depreciation of fixed assets	(10)
5.	It is EBIT [earnings before interest and tax] (3 - 4)	50
6.	Now deduct interest payable or paid from 5	(10)
7.	Balance (5 - 6) or EBT [earnings before tax]	40
8.	Now deduct Income-tax payable or paid from 7 say @ 30% on Rs.40	(12)
9.	Balance (7- 8) or EAT [earnings after tax]	28
10.	Add: depreciation in EAT (given in point no. 4)	10
11.	Now it is Cash Inflow as source of fixed capital	38

Thus, the total fixed capital requirement will be equal to Rs. 97 (i.e., outflows ₹ 135 minus inflows ₹ 38)

10.7 WORKING CAPITAL

Generally, working capital is an amount used to serve the business on day-to-day basis fulfilling the requirement of everyday production and operation. Working capital can be increased by profitable business operation, sale of long-term assets, long-term borrowing and investment by owners. It can be decreased by unprofitable business operations; purchase of long-term assets without long-term financing, distributing cash to owners. It is also called as circulating capital because most of the amount invested in current assets passes through a cycle as under:

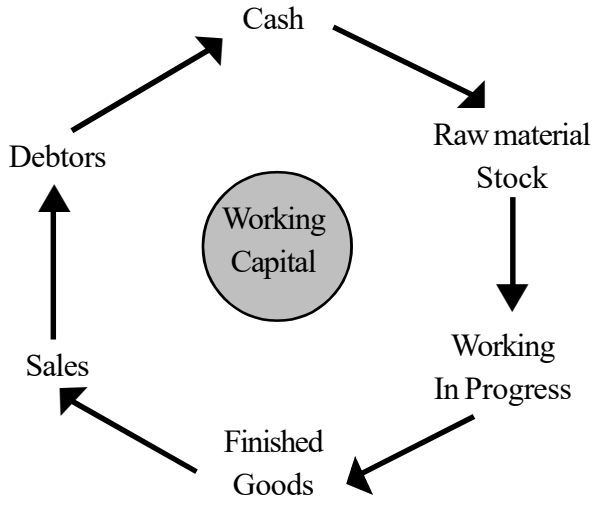


Fig.: 10.2 Working Capital

10.7.1 CONCEPT OF WORKING CAPITAL

The concept of working capital can be understood in two different ways. These are:

a) **Gross Concept of Working Capital:** It refers to the firm's investment in current assets. Current assets are those assets which can be readily convertible into cash within one accounting period; say 12 months.

(b) **Net Concept of Working Capital:** It refers to the excess of total of current assets over total of current liabilities or refers as current assets minus current liabilities. Current liabilities are those which can be payable within one year.

10.7.2 CHOICE OF THE CONCEPT

Choice of the concepts depends upon the objective of the study. If the objective is to assess the efficiency of the business, then the gross concept of working capital will be suitable. But if the objective is to assess the liquidity position, then net concept will be suitable.

10.7.3 TYPES OF WORKING CAPITAL

Working capital can be classified into two categories;

(a) **Permanent/Fixed Working Capital:** Every firm has to keep a minimum level of investment in current assets or core current assets to ensure the continuity of operations without any interruption which represents minimum levels of inventory, minimum level of amount always tied-up in debtors due to credit policy and reasonable amount of cash to meet the day-to-day working expenses of the business. A firm financesits core current assets in business operation through long-term sources.

(b) **Variable Working Capital:** It is also called as fluctuating working capital. The requirement of variable working capital depends upon the change in production and sales due to change in demand or seasonality of industry such as peak seasons and slump seasons over and above the permanent working capital. A firm finances its fluctuating needs of working capital through short-term debt.

10.7.4 WORKING CAPITAL VS. LIQUIDITY

A retailer, distributor or manufacturer may have a large amount of working capital in current assets. However, if most of its current assets are in slow-moving inventory, the company may not have the liquidity to pay its obligations on the agreed upon due dates. Similarly, if a company is unable to collect its accounts receivable, it may not have the liquidity to pay its obligations.

In contrast, consider a company that sells popular products online and customers pay with bank credit cards or debit cards when they order. Further, the company's suppliers allow the company to pay 60 days after it purchases the products. This company may have very little working capital, but it may have the liquidity it needs.

10.7.5 COMPONENTS OF WORKING CAPITAL

(a) Current Assets

A major component of working capital is current assets. A shortened definition of current assets is: a company's cash plus its other resources that are expected to turn to cash within one year. Example of current assets include:

(i) cash and cash equivalents

(ii) temporary or short-term investments

(iii) accounts receivable or debtors or book-debt

(iv) inventory such as raw materials, semi-finished goods and finished goods

(v) supplies

(vi) prepaid expenses

(b) Current Liabilities

The other major component of working capital is current liabilities. A shortened definition of current liabilities is: a company's obligations that will be due within one year. Examples of current liabilities include:

(i) Loan principal instalment amounts that will be due within one year

(ii) Accounts payable/sundry creditors

(iii) Bank overdraft/cash credit/ short-term loan

(iv) Wages payable

(v) Payroll taxes withheld from employees

(vi) Accrued expenses/liabilities (utilities, repairs, interest, etc.)

(vii) Customer deposits and deferred revenues

10.7.6 DIFFERENCE BETWEEN FIXED CAPITAL AND WORKING CAPITAL

Basis of difference	Fixed Capital	Working Capital
1. Meaning	Fixed capital is the investment done by the business for accruing longterm benefits.	Working capital is the daily requirement pumped into business.
2. Acquiring of assets	Fixed capital is used to acquire non-current assets.	It is used to acquire current assets.
3. Conversion	Can't be converted into cash or kind immediately.	Can be converted into cash within one year.
4. Tenure	Serves the business for longer period of time.	Serves the business for short period of time.
5. Benefits	Offer benefits for more than one accounting period.	Offer benefits for less than one accounting period.
6. Liquidity	Very low liquidity	High liquidity.

10.7.7 DETERMINANTS OF WORKING CAPITAL

A wide variety of factors influence the total investment in working capital in an enterprise. Significant among them are:

1. **Promotional and Formative Phase:** The start-up of a new project and initial years constitute the most crucial phase for planning and provisioning of working capital funds.

2. **Position of Business Cycle:** Movements of the business cycle bring about shifts in working capital position. The upward swing is associated with spurt in sales and increase in levels of inventories and book debts. On the other hand, when there is a downswing, the levels of inventories and book debts may fall, causing cash flux.

3. **Nature of Business:** The nature of business has an important bearing on its working capital needs. For some ventures, such as retail stores, tobacco manufacture, construction companies, etc., the fixed assets become nominal or incidental and they require an abundance of working capital.

4. **The Manufacturing Cycle:** An extended time span, between the raw material purchase and the completion of the manufacturing process yielding the finished product, will obviously mean a larger tie-up of funds in the form of enhanced working capital needs.

5. **Credit Terms to Customers:** The credit terms granted to customers influence the working capital level by determining the level of investment in book debts. Liberal credit and Slack collection procedures or permissive attitude in the matter of collection of outstanding can also lock up funds that would otherwise be available for operating needs.

6. **Vagaries in Supply of Raw Materials:** Some raw materials may be available only in certain seasons so that these have to be obtained and stored, in advance, for the lean months. The working capital requirements, in such circumstances, will register seasonal fluctuations.

7. **Shift in Demand for Products:** The rising stock levels during the periods of production in excess of demand will require increasing amounts of working capital to be provided and these funds will remain, tied-up in inventories for some months. The financial planning will have to incorporate this pattern of funds requirements associated with steady production and seasonal sales.

8. **Production Policies:** A strategy of steady rate of production policy being maintained throughout the year as against a pronounced seasonal demand for manufactured goods is considered threat to the business. The problem is of finding funds to support the mounting inventory levels of finished goods until they get offloaded in the peak season.

9. **Competitive Conditions:** The degree of competition is an important factor influencing working capital requirements. To win and retain customers it will also be necessary to extend generous credit terms, in keeping with competitor's practices, with very limited discretion in formulating

   own credit policies. The investment in book debts will, therefore, be of a high order requiring additional funds.

10. **Growth and Expansion Programmes:** As business grows, additional working capital has to be found. There is no simple formula to establish the link between growth in sales and growth in working capital or current assets.

11. **Profit Level:** By the very nature of things, some enterprises generate high gross margins, compared to others. High gross margins improve prospects of a higher rate of internal generation at the completion of each cash cycle which is based on the assumption that the benefit of high gross margin is not lost or dissipated in expensive enterprise activities in marketing and administrative areas.

12. **Taxation:** Tax liability is an inescapable element in working capital planning. It is a short-term liability payable in cash. Advance tax may have to be remitted in instalments, the computation being based on projected profits for the year. Periods of high taxation impose additional strain on working capital. The finance manager, who is well informed in tax matters, has appreciable scope for tax planning with a view-to reducing the cash drain by way of tax.

13. **Dividend Policy:** Dividend, once declared, is a short-term liability, leading to a cash outgo. There are statutory regulations governing prompt disbursements of dividends due and payable.

14. **Depreciation Policy:** Depreciation policy centres around the determination of the amount to be provided as depreciation charges to make up the ultimate resource for replacement of worn out or obsolete assets. The selection of the method of depreciation has important financial implications. If current capital expenditure falls short of the depreciation provision, working capital position is strengthened and there may be no need for short-term borrowing.

15. **Reserve Policy:** One of the cherished goals of enterprise management is to build up adequate reserves out of profits. Wherever the desire to build up reserves is dominant, working capital or funds position receives priority of consideration and dividends get a residual treatment.

16. **Price Level Changes:** It is also called as inflation. It is true that not all prices move at the same pace. Nor do they all move in the same direction. This diversity in price changes creates contradictions. It leaves some companies relieved of their working capital problems and, at the same time, it aggravates or intensifies the working capital problems of others.

17. **Operating Efficiency:** There is an obvious relationship between the operating efficiency of a company and its working capital position. Efficiency of operations accelerates the pace of the cash cycle, and improves the working capital turnover. It releases the pressure on working capital by improving profitability and aiding added internal generation of funds.

10.7.8 ESTIMATING WORKING CAPITAL REQUIREMENT

The need of working capital aims at maximizing the wealth of its shareholders. In this endeavour, a firm should earn sufficient return from its operations which requires successful sales activities. For which current assets are needed because sales do not convert into cash instantaneously. It involves an operating cycle in conversion of sales into cash. A firm requires many years to recover the initial investment in fixed assets. On the contrary, investment in current assets is turned over many times in a year leading to less requirement of investment in current assets.

The most appropriate method of estimating the working capital needs is the concept of operating cycle. However, a number of other methods may be used to determine working capital needs. These are:

(a) Current Assets Holding Period Method or Operating Cycle Approach:

This method is based on the operating cycle concept. It is the time duration required to convert sales, after the conversion of resources such as cash into inventories, into sales, into debtors and finally into cash. It is depicted as:

Net Operating cycle period =

Inventory conversion period + Debtors(receivable) conversion period - creditors deferred period.

Working capital needs =[Estimated cost of goods produced X Net operating cycle period] + permanent cash requirement.

(b) Ratio to sales: To estimate working capital needs as a ratio to sales on the assumption that current assets change with sales.

(c) Percentage of fixed investment: To estimate working capital needs as a percentage of fixed investment.

10.8 DIVIDEND DECISION

You have already learned that dividend decision is also one of the crucial areas of financial management. As you know that the rate of dividend to be payable at the time of raising capital by the issue of

preference share is fixed. Therefore, a company must pay dividend to its preference shareholder before paying dividend to equity shareholders. Hence, dividend decision is not concerned with paying dividend to preference shareholders but concerned with paying dividend to equity shareholders.

The important aspect of this decision is to determine how much amount of profit after tax is to be distributed to shareholders and how much amount is to be retained in the company for financing the growth and expansions of the business. Hence, framing of dividend policy involves the balancing of the shareholders' desire for current dividends and the company's need for funds for growth and expansion.

The main objective of a dividend policy should be to maximize the shareholder's return so that the value of his investment is maximized. Shareholders' return consists of dividend income and capital gain.

10.8.1 WHAT IS DIVIDEND?

Dividend constitutes the use of company's funds. Dividends are payments made by a company to its shareholder members. It is the portion of profits paid out to stockholders. Paying dividends is not an expense; rather, it is the division of an asset among shareholders.The amount of the dividend is determined every year at the company's annual general meeting, and declared as either a cash amount or a percentage of the company's profit. Once declared, a dividend becomes a liability of the firm. A high dividend yield is considered to be evidence that a stock is underpriced, whereas a low dividend yield is considered evidence that the stock is overpriced.

Holders of preference share get their regular dividend payment at fixed rate on the amount invested in the company out of profit but holders of equity share have no guarantee to receive dividend in spite of profit because it is the discretionary power of Board of Directors either to pay or not to pay any dividend; equity shareholders can't claim dividend.

10.8.2 MODE OF DIVIDEND PAYMENT

(a) **Cash Dividends:** When a company shares a portion of its net earnings with its shareholders in the form of cash, we call it cash dividend.

(b) **Stock Dividend:** It is also known as bonus shares. A dividend can be paid out in the form of shares of stock. Under the stock dividend issue, the company issues additional shares in a ratio to the investor's current holding. While the number of shares with an investor increases, the market value of the shares remains the same.

(c) **Stock Repurchase:** Under this type of dividend, the existing shareholder gets an option to sell his shares back to the company at a fixed rate. Generally, the fixed rate is higher than the prevailing market rate. It believes that the shares are undervalued. It also helps in reducing the price-to-earnings (P/E) ratio of the share. The earnings per share of the company will also increase. This way the investor gets some money back in his pocket and the promoters/ management gets higher shares in the company.

10.8.3 DIVIDEND PAYMENT PROCEDURE

(a) **Declaration Date:** The date on which the Board of Directors declare the dividend is called the 'declaration date'.

(b) **Record Date:** A shareholder is eligible to receive the dividend when his or her name is listed in the shareholder's register on 'record date'.

(c) **Payment Date:** The dividend cheques are mailed to shareholders on record.

(d) **Ex-dividend Date:** A share of stock becomes ex-dividend on the date the seller is entitled to keep the dividend. At this point, the stock is said to be trading ex-dividend. The buyer of an ex-dividend stock is not entitled to the next dividend payment.

10.8.4 DETERMINANTS TO DERIVE DIVIDENDS

The dividend to preference shareholders is paid at fixed rate and paid on priority basis i.e., before paying dividend 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. There are three main factors that may influence a company's dividend decision:

(a) **Free-cash Flow:** The Company simply pays out, as dividends, any cash that is surplus after it invests in all available positive net present value projects.

(b) **Dividend Clientele:** A particular pattern of dividend payments may suit one type of shareholder more than another. A retiree investor may prefer to invest in a company that provides a consistently high dividend yield, whereas a person with a high income bracket from employment may prefer to avoid dividends due to their high marginal tax rate on income. Although, dividend income received from an Indian company is exempt in the hands of shareholders either paid in the form of cash or bonus share until and unless sold out. If clientele exists for particular patterns of dividend payments, a company may be able to maximise its share price and minimise its cost of capital by catering to a particular clientele. Thus, this may lead to payment of relatively consistent dividend.

(c) **Information Signalling:** Dividend announcements convey information to investors regarding the company's future prospects. Suppose, if a company declared very high dividends, it gives a signal to prospective and present investors that the company has no future investment opportunities and vice-versa which decreases or increases the market price of the share. It is due to the information content of dividends.

TERMINAL EXERCISE

Very Short Answer Questions

1. What do you understand by financing decision?
2. What do you understand by dividend decision?
3. What do you understand by investment decision?
4. What is meant by financial planning?
5. State the components of working capital.
6. Describe the components of debt and equity.
7. Explain the importance of information signaling in dividend decision.

Short Answer Questions

1. Critically examine the objective of financial management.
2. Explain the concept of working capital and its choice.
3. State the sources of fixed capital.
4. Explain capital structure and its components.
5. Explain the cost and risk associated with equity and debt capital.
6. State any four objectives of financial planning.
7. Explain the different modes of dividend payments.
8. Differentite between fixed capital and working capital.
9. Distinguish between capital structure and financial structure.

Long Answer Questions

1. What is meant by 'Financial Planning'? Explain any four requisites of a sound financial plan.
2. How does raising of long term funds through debt affect the return on shareholders' funds? Explain with an example.
3. What is meant by 'dividend'? State the factors that affect dividend decision.
4. How do you assess the amount of working capital required by a business unit? Describe in brief.
5. "Financial management is much more than mere procurement of funds." Explain.
6. What is meant by the term 'leverage'? State the different types of leverages.

11.SHORT TERM SOURCES OF FINANCE

Mr. Anil Singh has been running a restaurant for the last two years. The excellent quality of food has made the restaurant popular in no time. Motivated by the success of his business, Mr. Singh is now contemplating the idea of opening a chain of similar restaurants at different places. However, the money available with him from his personal sources is not sufficient to meet the expansion requirements of his business. His father told him that he can enter into a partnership with the owner of another restaurant, who will bring in more funds but it would also require sharing of profits and control of business. He is also thinking of getting a bank loan. He is worried and confused, as he has no idea as to how and from where he should obtain additional funds. He discusses the problem with his friend Ramesh, who tells him about some other methods for raising the funds. He further cautions him that each method has its own advantages and limitations and his final choice should be based on factors like the purpose and period for which funds are required. He wants to learn about these methods.

LEARNING OUTCOMES

- describes short term sources of finance;
- identifies short term funding sources and instruments and
- explains long term finance sources, instruments and institutions providing long term funds.

11.1 BUSINESS FINANCE

Business finance refers to money and credit employed in business. Finance is the basis of business. It is required to purchase assets, goods, raw materials and for the other flow of economic activities. Business finance can be defined as 'the provision of money at the time when it is needed by a business'.

Financial needs of Business

Every Business needs capital. Capital is required at the time of beginning of the business. It is also needed when the business is in operation. As an enterprise grows in size and expands, it needs finance to establish. The capital requirements for business are divided into two classes which are discussed as under:-

- Fixed Capital
- Working Capital

1. Fixed Capital

Every business requires a sufficient amount of fixed capital for beginning its operational activities. As the name indicates, the amount of capital invested in various fixed or permanent assets, which are necessary for conducting the operation of a business is known as fixed capital. These fixed assets might be land, building, machinery, equipment etc. The fixed assets normally do not change their form and cannot be withdrawn from the business at a short notice. They can, however be

disposed off. Fixed capital thus are the funds required for the purchase of those assets that are to be used over and over for a long period of time in business.

Investments in non-current assets such as goodwill, patent, rights, copyrights, long term receivables etc. also form a part of fixed assets. The amount of capital required for investment in fixed assets varies with size, nature and method of production of business. Summing up, fixed capital comprises of fixed assets and other non-current assets.

Importance of Fixed Capital

Right from the very beginning i.e. conceiving an idea of business, purchase of land, construction of building, purchase of machinery, capital etc. is needed. Further, for the expansion and modernization of machinery also fixed capital is required. So it is essential to have an adequate amount of fixed capital in an enterprise.

2. Working Capital

In balance sheet terms, working capital is the difference between current assets and current liabilities of a business. Current assets refer to those assets, which can be easily changed into cash within a short period of time in the business, in an accounting year. It consists of cash in hand and bank balances, bills receivable, short term investments, and inventories of stocks. While on the other hand, current liabilities are those which are intended to be paid within a short period of one accounting year out of the current assets. It consists of bills payable, short term loans, bank overdraft, dividends payable, taxes payable etc. Working capital also called circulating capital, is the life blood and nerve center of a business. Working capital is mostly used for the purchase of raw material, payment of wages, seasonal urgent demands of the business, purchase of more goods for sale, meeting the expenses of advertising, providing credit facilities to the customers etc.

Current assets - Current Liabilities = Working Capital

The difference between the current assets and current liabilities is surplus, the business has a positive working capital. In case the difference is negative, then the business has a negative or deficient working capital.

Importance of Working Capital

The importance of working capital is discussed below:

a) Solvency of Business: It helps in solvency of the business. The flow of production remains uninterrupted.

b) Goodwill: The entrepreneur is able to pay wages to the workers and other bills in time. This helps in creating goodwill of business.

c) Loans on Favorable Terms: A business with high solvency and greater good will can easily obtain loan from banks.

d) Cash Discounts: A business with adequate working capital can obtain cash discounts on the purchases. This helps in reducing cost.

e) Enables to Face Crisis: An adequate working capital enables an enterprise to face business crisis.

f) Regular Payment of Dividend: A sufficient amount of working capital enables a business to earn profit and pay dividend to investors in time.

11.2 TYPES OF BUSINESS FINANCE

The need for finance may be for long-term, medium-term or short-term. Financial requirements with regard to fixed and working capital vary from one organisation to another. To meet out these requirements, funds need to be raised from various sources. Some sources like issue of shares and debentures provide money for a longer period. These are therefore, known as sources of long-term finance. On the other hand sources like trade credit, cash credit, overdraft, bank loan etc.which make money available for a shorter period of time are called sources of short-term finance. So based on the period for which the funds are required, business capital is classified into three categories:

1) Short-term Capital

2) Medium-term Capital

3) Long-term Capital

Short-term Capital: Short-term funds are those which are required for a period not exceeding one year. Trade credit, loans from commercial banks and commercial papers are some of the examples of the sources that provide funds for short duration. Shor term financing is most common for financing of current assets such as accounts receivable and inventories.

Medium-term Capital: Where the funds are required for a period of more than one year but less than five years, medium-term sources of finance are used. These sources include borrowings from commercial banks, public deposits, lease financing and loans from financial institutions.

Long-term Capital: The long-term sources fulfill the financial requirements of an enterprise for a period exceeding 5 years and include sources such as shares and debentures, long-term borrowings and loans from financial institutions. Such financing is generally required for the acquisition of fixed assets such as equipment, plant, etc. In this lesson we will study about the various sources of short-term finance in detail and their relative merits and demerits.

11. 2.1 SHORT-TERM FINANCE

Short-term Finance/Capital refers to financing for a small period normally less than a year. It is also known as Working Capital Financing. Short-term Finance is used for working capital requirement. The availability of short-term funds is essential. Inadequacy of short-term funds may even lead to closure of business.

11.2.2 PURPOSES OF SHORT-TERM CAPITAL

Short-term finance serves following purposes:

i. It facilitates the smooth running of business operations by meeting day-to-day financial requirements.

ii. It enables firms to hold stock of raw materials and finished products.

iii. With the availability of short-term finance, goods can be sold on credit. Sales are for a certain period and collection of money from debtors takes time. During this time gap, production continues and money will be needed to finance various operations of the business.

iv. Short-term finance becomes more essential when it is necessary to increase the volume of production at a short notice.

v. Short-term funds are also required to allow flow of cash during the operating cycle. Operating cycle refers to the time gap between commencement of production and realization of sales.

11.2.3 MERITS AND DEMERITS OF SHORT-TERM FINANCE

Short-term loans help business concerns to meet their temporary requirements of money. They do not create a heavy burden of interest on the organisation. But sometimes organisations keep away from such loans because of uncertainty and other reasons.Let us examine the merits and demerits of short-term finance.

Merits of short-term Finance

a) **Economical:** Finance for short-term purposes can be arranged at a short notice and does not involve any cost of raising. The amount of interest payable is also affordable. It is, thus, relatively more economical to raise short-term finance.

b) **Flexibility:** Loans to meet short-term financial need can be raised as and when required. These can be paid back if not required. This provides flexibility.

c) **No interference in Management:** The lenders of short-term finance cannot interfere with the management of the borrowing concern. The management retains their freedom in decision-making.

d) **May also Serve Long-term Purposes:** Generally business firms keep on renewing short-term credit. For example, cash credit is granted for one year but it can be extended up to 3 years with annual review. After three years it can be renewed. Thus, sources of short-term finance may sometimes provide funds for long-term purposes.

Demerits of Short-term Finance

Short-term finance suffers from a few demerits which are listed below:

a) **Fixed Burden:** Like all borrowings interest has to be paid on short-term loans irrespective of profit or loss earned by the organisation. That is why business firms use short-term finance only for temporary purposes.

b) **Charge on Assets:** Generally short-term finance is raised on the basis of security of moveable assets. In such a case the borrowing concern cannot raise further loans against the security of these assets nor can these be sold until the loan is cleared (repaid).

c) **Difficulty of Raising Finance:** When business firms suffer intermittent losses of huge amount or market demand is declining or industry is in recession, it loses its creditworthiness. In such circumstances they find it difficult to borrow from banks or other sources of short-term finance.

d) **Uncertainty:** In cases of crisis business firms always face the uncertainty of securing funds from sources of short-term finance. If the amount of finance required is large, it is also more uncertain to get the finance.

e) **Legal Formalities:** Sometimes certain legal formalities are to be complied with for raising finance from short-term sources. If shares are to be deposited as security, then transfer deed must be prepared. Such formalities take a lot of time and create lots of complications.

11.3 METHODS FOR RAISING SHORT-TERM CAPITAL

As we understood, when we need short-term financing, there are various methods for raising short-term financing for a business. Each type of short-term finance has different characteristics and can be used in different situations. There are a number of methods for raising short-term finance which are listed below:

Some of these are explained below:

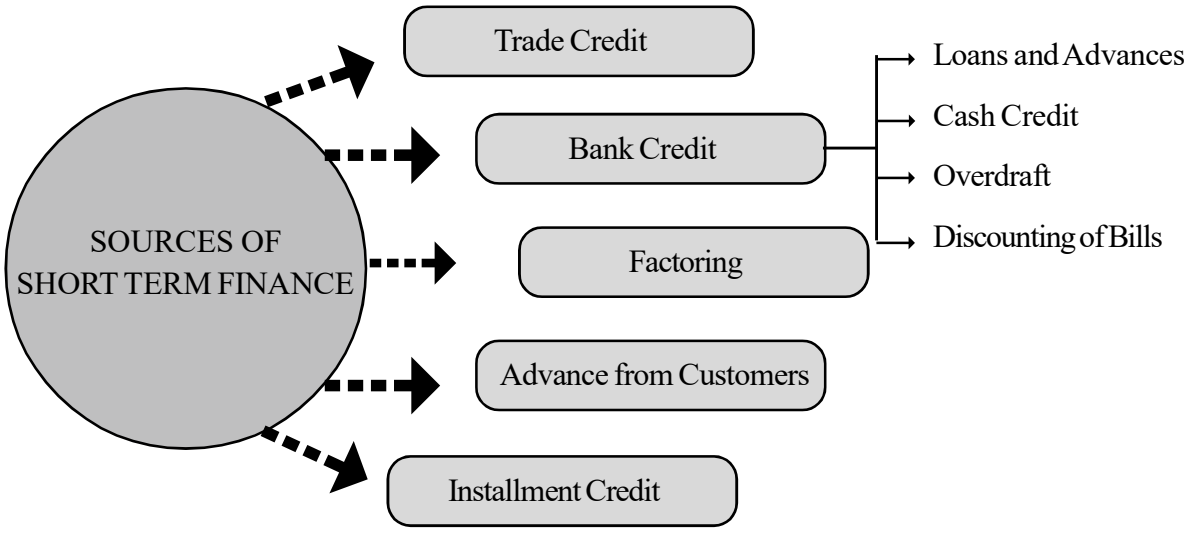


Fig.: 11.1 Sources of Short Term Finance

11.3.1 TRADE CREDIT

Trade credit refers to credit granted to manufactures and traders by the suppliers of raw material, finished goods, components, etc. Usually business enterprises buy supplies on a 30 to 90 days credit. It is the credit extended by the accounts payables.

We could classify this credit into 2 types - **free trade credit and paid trade credit.** After a particular no. of days as per payment terms, the supplier charges interest on the delay of payment. So, the period before this is free trade credit and after that is paid trade credit.

It's quite obvious that the free trade credit should be as much as possible because it is free of cost. How much is free trade credit extended to a customer? It depends upon the creditworthiness of the buyer, discipline maintained in payment commitments, the bulk of the business, etc. The higher your rate on these factors, the higher would be the free trade credit available to your business.

Paid trade credit is definitely a type of short-term financing, but on the priority list, it would be quite below. In short, it should be selected only when another financing is not available. The reason for not opting for it is its high-interest cost.

Merits of Trade Credit

The important merits of trade credit are as follows:

(i) Trade credit is a convenient and continuous source of funds.

(ii) Trade credit may be readily available in case the credit worthiness of the customers is known to the seller.

(iii) Trade credit needs to promote the sales of an organisation.

(iv) If an organisation wants to increase its inventory level in order to meet expected rise in the sales volume in the near future, it may use trade credit to finance the same.

(v) It does not create any charge on the assets of the firm while providing funds.

Demerits of Trade Credit

Trade credit as a source of funds has certain limitations, which are described as follows:

(i) Availability of easy and flexible trade credit facilities may induce a firm to indulge in overtrading, which may add to the risks of the firm.

(ii) Only limited amount of funds can be generated through trade credit.

(iii) It is generally a costly source of funds as compared to most other sources of raising money.

11.3.2 BANK CREDIT

Commercial banks grant short-term finance to business firms which are known as bank credit. When bank credit is granted, the borrower gets a right to draw the amount of credit at one time or in instalments as and when needed. Bank credit may be granted by way of loans, cash credit, overdraft and discounted bills.

(i) Loans & Advances

When a certain amount is advanced by a bank repayable after a specified period, it is known as bank loan. Such an 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.

(ii) 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. Initially this limit is granted for one year. This limit can be extended after review for another year. However, if the borrower still desires to continue the limit, it must be renewed after three years. Rate of interest varies depending on the amount of limit.

Banks ask for collateral security for the grant of cash credit. In 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.

(iii) Overdraft

When a bank allows its depositors or account holders to withdraw money in excess of the balance in his account upto a specified limit, it is known as overdraft facility. This limit is granted purely on the basis of creditworthiness of the borrower. Banks generally give the limit upto Rs.20,000. In this system, the borrower has to show a positive balance in his account on the last Friday of every month. Interest is charged only on the overdrawn money. Rate of interest in case of overdraft is less than the rate charged under cash credit.

(iv) Discounting of Bills

Banks also advance money by discounting bills of exchange i.e. promissory s. When these documents are presented before the bank for discounting, banks credit the amount to customer's account after deducting discount. The amount of discount is equal to the amount of interest for the period of bill.

Difference between trade credit & bank credit

Sl. No.	Attributes	Trade Credit	Bank Credit
1.	Length of Terms	Relatively Short usually 30, 60 or 90 days	Ignore
2.	Security	Usually unsecured	High Standards for unsecured loans, otherwise secured.
3.	Amount Involved	Smaller	Larger
4.	Resource Transferred	Goods or Services	Money
5.	Extent of Analysis	Extensive when size of transaction is large	In-depth analysis regarding safety and collectability.

11.3.2.1 TYPES OF SECURITIES REQUIRED FOR BANK CREDIT

Loans and advances are granted by bank on personal security of the borrower as well as on the security of some tangible assets, besides the goodwill of the firm. Thus securities against bank credit may be of two types:

(i) Personal Security

(ii) Security of Tangible Assets.

Personal security means the credit-worthiness of the borrower. Banks judge the creditworthiness of the borrower on the basis of financial worthiness and past dealings with the bank.

The following tangible assets are accepted by banks 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 the bank.

b) **Shares and Stock:** Shares and stock that are quoted on a recognized stock exchange are accepted as security against bank credit. The borrower is required to deposit the share certificate along with a transfer deed signed by him as security.

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 favor 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. The interest charged on loan is higher than the interest allowed on deposit. 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. Proprietary concerns sometimes offer jewellry or other precious metals to obtain credit.

g) **Other Securities:** Besides the assets and documents mentioned above, banks also accept National Savings Certificate (NSC), Indira Vikas Patra (IVP), and KisanVikas Patra (KVP) to grant short-term credit.

11.3.3 FACTORING

Factoring is also a similar arrangement like invoice discounting where the accounts receivables of a business are sold to a third party at a price which is lower to the realizable value of the accounts receivable. This purchasing party is commonly known as a factor. These factoring services are provided by both banks and other financial institutions. There are many types of factoring like with recourse or without recourse etc. Factoring is a financial service under which the 'factor' renders various services which include:

(a) Discounting of Bills (with or without recourse) and Collection of the Client's Debts under this, the receivables on account of sale of goods or services are sold to the factor at a certain discount. The factor becomes responsible for all credit control and debt collection from the buyer and provides protection against any bad debt/losses to the firm. There are two methods of factoring - recourse and non-recourse. Under recourse factoring, the client is not protected against the risk of bad debts. On the other hand, the factor assumes the entire credit risk under non-recourse factoring i.e., full amount of invoice is paid to the client in the event of the debt becoming bad.

(b) Providing Information about Credit Worthiness of Prospective Client's etc., Factors hold large amounts of information about the trading histories of the firms. This can be valuable to those who are using factoring services and can thereby avoid doing business with customers having poor payment record. Factors may also offer relevant consultancy services in the areas of finance, marketing, etc. The factor charges fees for the services rendered. Factoring appeared on the Indian financial scene only in the early nineties as a result of RBI initiatives. The organisations that provide such services include SBI Factors and Commercial Services Ltd., State Bank of India, Punjab National Bank, Allahabad Bank etc. In addition, many non-banking finance companies and other agencies provide factoring service.

Merits of Factoring

The merits of factoring as a source of short-term finance are as follows:

(i) Obtaining funds through factoring is cheaper than financing through other means such as bank credit.

(ii) With cash flow accelerated by factoring, the client is able to meet his/her liabilities promptly as and when these arise.

(iii) Factoring as a source of funds is flexible and ensures a definite pattern of cash inflows from credit sales. It provides security for a debt that a firm might otherwise be unable to obtain.

(iv) It does not create any charge on the assets of the firm.

(v) The client can concentrate on other functional areas of business as the responsibility of credit control is shouldered by the factor.

Demerits of Factoring

The demerits of factoring as a sourceof short-term finance are as follows:

(i) This source is expensive when the invoices are numerous and smaller in amount.

(ii) The advance finance provided by the factor firm is generally available at a higher interest cost than the usual rate of interest.

(iii) The factor is a third party to the customer who may not feel comfortable while dealing with it.

11.3.4 ADVANCE FROM CUSTOMERS

Customers' advance refers to advance made by the customer against the value of order placed. It is, thus, a part payment of the value of goods to be supplied later.

Merits

(a) Interest Free: Amount offered as advance is interest free. Hence,funds are available without involving financial burden.

(b) No Tangible Security: The seller is not required to deposit any tangible security while seeking advance from the customer. Thus assets remain free of charge.

(c) No Repayment Obligation: Money received as advance is not to be refunded. Hence there are no repayment obligations.

Demerits

(a) Limited Amount: The amount advanced by the customer is subject to the value of the order. Borrowers' need may be more than the amount of advance.

(b) Limited Period: The period of customers' advance is only up to the delivery of goods. It cannot be reviewed or renewed.

(c) Penalty in case of Non-delivery of Goods: Generally advances are subject to the condition that in case goods are not delivered on time, the order would be cancelled and the advance would have to be refunded along with interest.

11.3.5 INSTALMENT CREDIT

Instalment credit is a system under which a small payment is made at the time of taking possession of the goods and the remaining amount is paid in instalments. Instalment money is inclusive of interest.

Merits of Instalment Credit

(i) Immediate Possession of Assets: Delivery of assets is assured immediately on payment of initial instalment (down payment).

(ii) Convenient Payment for Assets and Equipment: Costly assets and equipment which cannot be purchased due to inadequacy of long-term funds can be conveniently purchased on payment by instalments.

(iii) Saving of One Time Investment: If the value of asset or equipment is very high, funds of the business are likely to be blocked if lumpsum payment is made. Instalment credit leads to saving on one time investment.

(iv) Facilitation of Expansion and Modernization of Business and Office: Business firms can afford to buy necessary equipment and machines when the facility of payment in instalments is available. Thus, expansion and modernization of business and office are facilitated by instalment credit.

Demerits of Instalment Credit

(i) Committed Expenditure: Payment of instalment is a commitment to pay irrespective of profit or loss in the business.

(ii) Obligation to Pay Interest: Under instalment credit system payment of interest is obligatory. Generally sellers charge a high rate of interest.

(iii) Additional Burden in Case of Default: Sellers sometimes impose stringent conditions in the form of penalty or additional interest, if the buyer fails to pay the instalment amount.

(iv) Cash Does Not Flow: Like trade credit, instalment credit facilitates the purchase of asset or equipment. It does not make cash available which can be utilized for all needful purposes.

TERMINAL EXERCISE

1. List the various needs of the Business for which funds are required.
2. State the Merits & Demerits of Short-term Capital.
3. Why is short-term finance a necessity for business enterprises?
4. List the various sources of short-term finance.
5. Enumerate the various points of difference between cash credit and bank overdraft.
6. State the merits and demerits of Factoring and Instalment Credit as methods of business finance.

12. LONG-TERM SOURCES OF BUSINESS FINANCE

In the previous lesson we discussed about the various sources of short term finance. The funds that are invested in business for a long period of time, that is more than one year are known as long term finance. In this chapter we will learn more about it.

LEARNING OUTCOMES

- state the meaning, nature and need of long-term finance;
- identifies the different sources of long-term finance, both internal and external ;
- explains the various sources of long-term finance;
- outline the merits and demerits of the various sources of raising long-term finance; and
- understand the factors affecting choice of source of funds.

12.1 LONG TERM FINANCE

The funds which are not to be paid back within a period of one year are referred to as Long-term sources of finance. Certain long-term finance options directly form a part of the permanent capital of the firm. In such cases, the repayment obligation does not even arise.The long-term finance is also known as fixed capital.

12.1.1 NEED FOR LONG-TERM FINANCE

1) Long-term finance covers the requirements of fixed assets like land, building, plant, machinery, equipment, technical collaboration fee etc.

2) It is also required for major corporate restructuring including mergers, acquisitions, takeovers, modernisation etc.

3) Long-term finance is required to invest in R&D (Research and Development) operations.

4) It is required for designing marketing strategy or increasing facilities.

5) It also covers a component of working capital requirement which is nonfluctuating part of working capital.

12.2 SOURCES OF LONG-TERM FINANCE

The long-term financing could be done internally, i.e. from within the organisation or externally, i.e. from outside the organisation.

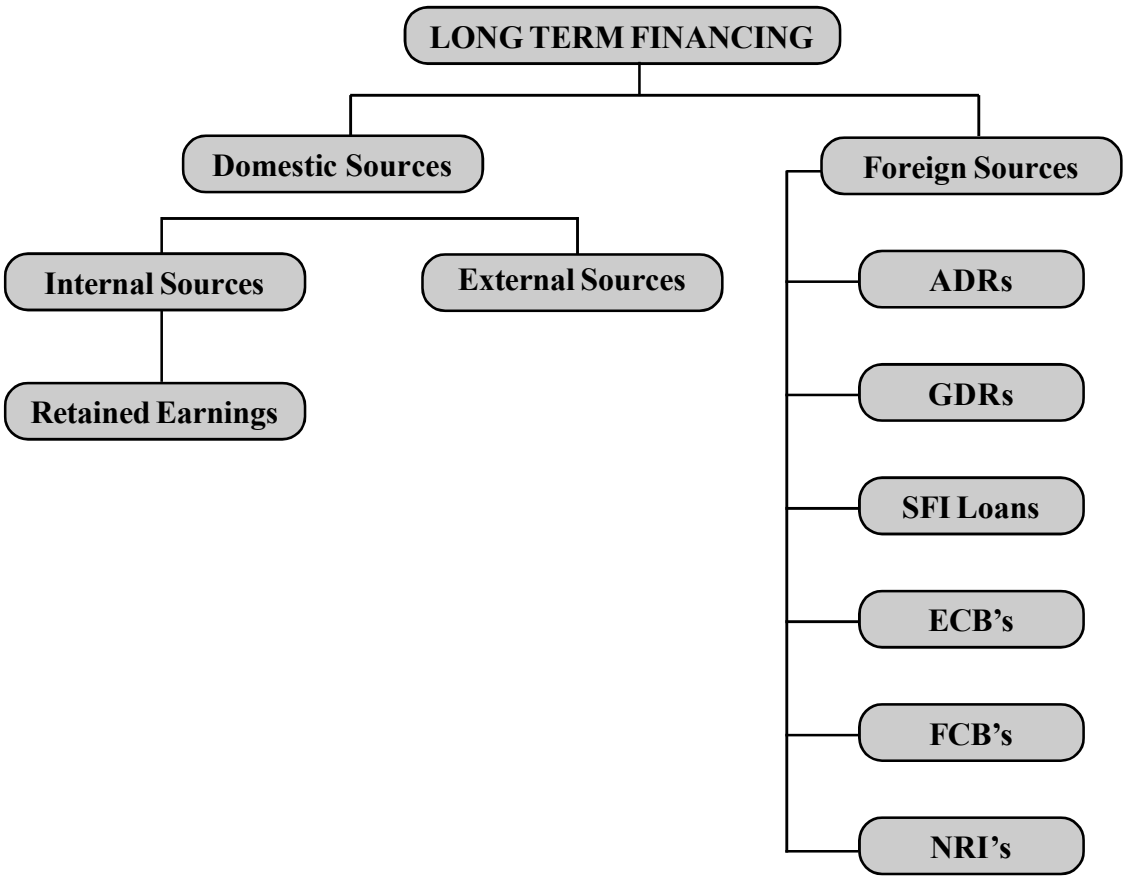


Fig. 12.1 Sources of Long-Term Finance

12.2.1 DOMESTIC SOURCES

Long-term finances may be domestically raised either internally i.e. from within the business, or externally i.e. from outside the business. External sources of long-term financing are discussed extensively later in the lesson. The key internal source – retained earnings - is discussed first.

A. Internal Source - Retained Earnings

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 The Companies Act 2013, 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. **Bring 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 their 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.

Demerits

Following are the limitations of retention of profit:

1. **Only Possible in Case of High Profits:** This method of financing is possible only when the company earns huge profits and that too for many years.

2. **May Cause Dissatisfaction among Shareholders Expecting Dividends:** 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. **May result in Mismanagement of Funds by the Management:** 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 term interest of the shareholders.

B. EXTERNAL SOURCES

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 externally. Following are the most commonly used methods of long-term finance from External Sources. Let us now discuss about these in detail.

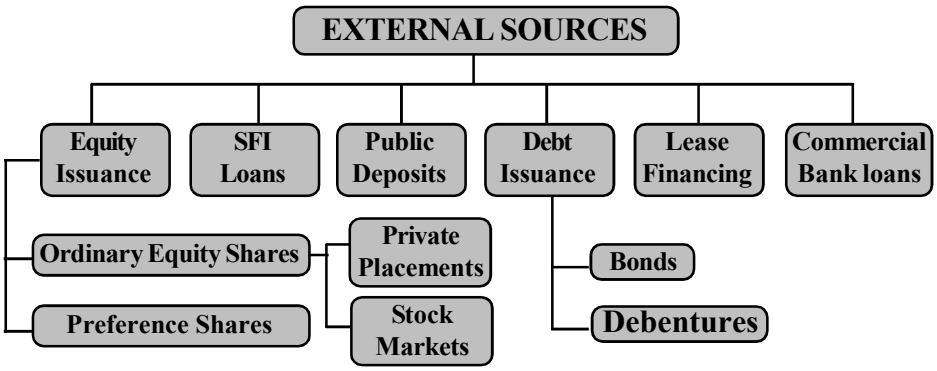


Fig. 12.2 External Sources of Long-term Financing

Let us now discuss about these in detail.

I. Equity Issuance

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 shares. 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 buys 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 the future. In order to tap the savings of different types of people, a company can issue two types of shares, viz. (a) Ordinary Equity, and (b) Preference shares.

(a) Ordinary 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 dividend on preference shares. There is no fixed rate of dividend for equity shareholders. The rate of dividend depends upon the surplus profits. In case there are good profits, the company pays dividend to the equity shareholders at a higher rate. Again in case of winding up of a company, the equity share capital is refunded only after refunding the claims of others. In fact they are regarded as the owners of the company who exercise their authority through the voting rights they enjoy. The money raised by issuing such shares is known as equity share capital. It is also called as ownership capital or owners' fund.

Merits of Equity Shares

From Shareholders' point of view

- The equity shareholders are the owners of the company.
- It is suitable for those who want to take risk for higher return.
- The value of equity shares goes up in the stock market with the increase in profits of the concern.
- Equity shares can be easily sold in the stock market.
- The liability is limited to the nominal value of shares.
- Equity shareholders have a say in the management of a company as they are conferred with voting rights.

From Management's point of view

- A company can raise capital by issuing equity shares without creating any charge in 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.

Demerits 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's 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 influence 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.

Issuance of Equity Shares

Stock Markets

Equity Shares may be issued either on domestic stock markets, like NSE and BSE. However, to be able to issue equity on stock markets, the issuing company is required to be a certain size and at a certain stage of growth. Moreover, issuance on stock markets is a fairly complex process which is time-consuming and expensive.

Private Placements

Sometimes, to avoid the complexities and restrictions of equity issuance on stock markets, companies may decide to issue fresh equity through private means. This process is called Private Placement of

Equity. Private Placements may be done to different entities like Angel Investors, Venture Capitalists or Private Equity Investors. These entities typically invest for long-term in growth-stage companies, which would otherwise find it difficult to raise capital through stock markets and bank financing. These investors bring equity capital to high-risk companies that may have a high possibility of failure.

Thus when shares are issued to privately known individuals or institutions, it is known as private placement of shares.

(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 Shares

A company has the option to issue different types of preference shares. Let us look at different types of preference shares a company can issue.

(i) Convertible and Non-convertible Preference Shares: The preference shares which can be converted into equity shares after a specified period of time are known as convertible preference shares. Otherwise, they are known as nonconvertible preference shares.

(ii) Cumulative and Non-cumulative Preference Shares: In cumulative preference shares, the unpaid dividends are accumulated and carried forward for payment in future years. On the other hand, in non-cumulative preference shares, the dividend is not accumulated if it is not paid out of the current year's profit.

(iii) Participating and Non-participating Preference Shares: Participating preference shares have a right to share the profit after making payment of dividend at a pre-decided rate to the equity shares. The non-participating preference shares do not enjoy such a right.

(iv) Redeemable and Irredeemable Preference Shares: Preference shares having a fixed date of maturity are called redeemable preference shares. Here, the company undertakes to return the amount to the preference shareholders immediately after the expiry of a fixed period. On the other hand, where the amount of the preference shares is refunded only at the time of liquidation, those 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 FOR COMPARISON	EQUITY SHARES	PREFERENCESHARES
Meaning	Equity shares are the ordinary shares of the company representing the part ownership of the shareholder in the company.	Preference shares are the shares that carry preferential rights on the matters of payment of dividend and repayment of capital.
Payment of dividend	The dividend is paid after the payment of all liabilities.	Priority in payment of dividend over equity shareholders.
Repayment of capital	In the event of winding up of the company, equity shares are repaid at the end.	In the event of winding up of the company, preference shares are repaid before equity shares.
Rate of dividend	Fluctuating	Fixed
Redemption	No	Yes
Voting rights	Equity shares carry voting rights.	Normally, preference shares do not carry voting rights.
Convertibility	Equity shares can never be converted.	However, in special circumstances, they get voting rights.
Arrears of Dividend	Equity shareholders have no rights to get arrears of the dividend for the previous years.	Preference shares can be converted into equity shares. Preference shareholders generally get the arrears of dividend along with the present year's dividend, if not paid in the previousyear(s), except in the case of non-cumulative preference shares.

II. Debt Issuance

(a) 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 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. 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 debenture holders 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 debenture holders 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) Debenture holders have no right either to vote or take part in the management of the company. So, by issuing debentures, the company raises additional capital without diluting 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.

Demerits 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 debenture holders. 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.

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 debenture holders 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 debentures.

(iv) Registered and Bearer Debentures: For registered debentures the issuing company maintains a record of the debenture holders. Any sale or transfer of such debentures must be registered with the company. On the other hand, bearer debentures are just like negotiable instruments and transferable by mere delivery. The company keeps no record of such debenture-holders. Interest coupons are attached to them and anybody can produce the coupon to get the interest. After having some idea about shares and debentures let us find out the difference between them.

Difference between Shares and Debenture

BASIS	SHARES	DEBENTURES
1. Status	Shareholders are the owners of the company. They provide ownership capital which is not refundable unless the company is liquidated.	Debenture holders 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.	Debenture holders 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 debenture holders and creditors.	Debenture holders have the priority of repayment over shareholders.
6. Risk	Risk is high due to uncertainty of returns.	Little risk due to certainty of return.

III. Loan from Domestic Special Financial Institutions (SFIs)

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 company's 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.

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.

IV. Borrowing From Commercial Banks

Commercial banks in India may grant loans for a period of 3 to 5 years. These loans may be accessed by the companies for a variety of uses including capital expenditure. These may be issued against or without a collateral - depending on the company's credit standing.

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 instalments.
6. In case of small-scale industries and for industries in villages and backward areas, the interest charged is very low.

Demerits:

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.

V. 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 sixty months.

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 secure. 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 on 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.

Demerits

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 deposit

VI. 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.

Merits:

The important merits of lease financing are:

1. It enables the lessee to acquire the asset with a lower investment.
2. Simple documentation makes it easier to finance assets.
3. Lease rentals paid by the lessee are deductible for computing taxable profits
4. It provides finance without diluting the ownership or control of business.
5. The lease agreement does not affect the debt raising capacity of an enterprise.
6. The risk of obsolescence is borne by the lesser. This allows greater flexibility to the Lessee to replace the asset.

Demerits:

The limitations of leasing finance are given below

1. A lease agreement may impose certain restrictions on the use of assets. For example, it may not allow the lessee to make any alteration or modification in the asset.

2. The normal business operations may be affected in case the lease is not renewed.

3. It may result in higher payout obligation in case the equipment is not found useful and the lessee opts for premature termination of the lease agreement.

4. The lessee never becomes the owner of the asset. It deprives him of the residual value of the asset.

12.2.2 FOREIGN SOURCES

(i) American Depository Receipts (ADRs)

The depository receipts which are issued by a USA-based bank for trading only in American Stock markets are known as American Depository Receipts (ADR). The ADRs are issued only to the American citizens.

(ii) Global Depository Receipts (GDRs)

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 form 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 voting rights. Many Indian companies like ICICI, Wipro etc. have raised foreign capital through issue of GDRs.

(iii) Loans from multinational Special Financial Institutions (SFIs)

Sometimes, companies may also take loan from international financial institutions like The World Bank and the International Finance Corporation (IFC), either directly or by way of refinancing. This funding is especially common in financing of infrastructure products and businesses operating in priority sectors.

(iv) External Commercial Borrowings (ECBs)

Sometimes, to take advantage of lower interest rates applicable on borrowings on foreign currencies, companies may also seek to avail long-term foreign currency borrowings from foreign banks. These borrowings are called External Commercial Borrowings. While the pricing of these borrowings may turn out to be lower than that of local borrowings, the borrowers of ECBs may be exposed to adverse currency fluctuations.

(v) Foreign Currency Convertible Bonds(FCCBs)

These are equity linked debt securities that are to be converted into equity or depository receipts after a specific period.Thus, a holder of FCCB has the option of either converting them into equity shares at a predetermined price or exchange rate, or retaining the bonds. The FCCBs are issued in a foreign currency and carry a fixed interest rate which is lower than the rate of any other similarnon-convertible debt instrument. FCCBs are listed and traded in foreign stock exchanges. They are very similar to convertible debentures issued in India.

(vi) Non-Resident Indians Financing (NRIs financing)

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.

12. 3 FACTORS AFFECTING CHOICE OF SOURCE OF FUNDS

Financial needs of a business are of different types-long-term, short-term, fixed and fluctuating. Therefore business firms resort to different types of sources for raising funds.

Each source of funds has its own merits and limitations, it is advisable to use a combination of sources, instead of relying only on a single source of fund. The factors that affect the choice of the source of finance are discussed below:

1. **Cost:** There aretwo types of cost viz.,the cost of procurement of funds and cost of utilising of funds.Both these costs should be taken into account while deciding about the source of funds that will be used by an organisation.

2. **Financial Strength and Stability of Operations :** The financial strength of a business is a key determinant in the choice of sources of funds. Business should be in a sound financial position to repay the principal amount and interest on the borrowed amount.

3. **Form of Organisation and Legal Status:** The form of business organisation and status influences the choice of source for raising money. A partnership firm for example cannot raise money by issue of equity shares as these can be issued only by a joint stock company.

4. **Purpose and Time Period:** Business should plan according to the time period for which the funds are required.Similarly the purpose for which funds are required need to be considered so that the source is matched with the use. For example, a long-term business expansion plan should not be financed by a bank overdraft which will be required to be repaid in the short term.

5. **Risk Profile:** Business should evaluate each of the source of finance in terms of risk involved. For example there is least risk in equity as share capital is to be repaid back only at the time of winding up and need not be paid if no profits are available. A loan on the other hand has a repayment schedule for both the principal and the interest.

6. **Control:** A particular source of funds may affect the control and power of the owners on the management of a firm.For example, issue of equity shares may mean dilution of the control, as equity shareholders enjoy voting rights. Financial institutions may take control of the assets or impose conditions as part of the loan agreement. Thus business firm should choose a source keeping in mind the extent to which they are willing to share their control over business.

7. **Effect on Credit-worthiness:** The dependence of business on certain sources may affect its credit-worthiness in the market. For example, issue of secured debentures may affect the interest of unsecured creditors of the company and may adversely affect their willingness to extend further loans as credit to the company.

8. **Flexibility and ease of obtaining funds:** Restrictive provisions, detailed investigation and documentation in case of borrowings from banks and financial institutions for example may be the reason that a business organisation may not prefer it, if other options are readily available.

9. **Tax benefits:** Various sources may also be weighed in terms of their tax benefits. For example, while the dividend on preference shares is not tax deductible and may not be preferred by organisations seeking tax advantage. For seeking tax benefit,fixed charged securities (debt) are preferred.

TERMINAL EXERCISE

Very Short Answer Questions

1. What is meant by lease financing?

2. State the meaning of 'Preference shares'.

Short Answer Questions

1. Distinguish between GDR and ADR.

2. 'Finance is considered as the life-line of the business, especially in the modern day'. Give reasons for the same.

3. Give two merits and two limitations of equity shares, from the point of view of the management.

4. Explain the four types of preference shares that a company can issue.

Long Answer Questions

1. What are 'Debentures'? Describe three merits and three limitations of debentures as a source of long-term finance for a company.

2. Differentiate between 'Shares' and 'Debentures' as sources of long-term finance.

3. 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.

4. Write explanatory s on: (a) Retention of Profits; and (b) Public Deposits, as methods of Long-term finance.

13.THE 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 required funds but also a transmission mechanism with the help of which the providers of funds (investors/ lenders/depositors) can interact with the borrowers/users (business units as well as non-business units) and transfer the funds to them as and when required. This aspect is taken care of by the concept called financial markets which provide a place/mechanism/system through which the transfer of funds by investors/lenders to the business units is adequately facilitated.

LEARNING OUTCOMES

- describes the role and importance of financial market and capital market; and
- identifies different types of financial instruments available for trade in capital market and money market.

13.1 FINANCIAL MARKET

We know that, money always flows from surplus sector to deficit sector. That means persons/ institutions having excess of money lend it to those who need money to fulfil 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 consider 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 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 relating to money markets.

A **bill of exchange** is an instrument in writing containing an unconditional order, signed by the maker (creditor), directing a certain person (debtor) 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 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 of 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** is an instrument in writing (not being a bank or a currency) 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.**

Let us now see the main functions of financial market.

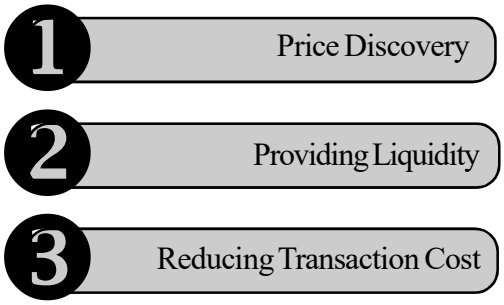


Fig. 13.1 Functions of Financial Markets

Financial markets essentially perform three important functions which are (1) price discovery (2) providing liquidity and (3) reducing transaction costs. We will deal with these functions in detail.

(1) Price Discovery: It symbolizes interaction between the buyer and sellers in the financial market which determines the price of the financial instrument/asset. Financial markets also help in allocation of funds by those who want to invest/ lend amongst those who are in need of funds.

(2) Providing Liquidity: Presence of financial markets provides liquidity to financial instruments as it provides a platform to the investors to sell their financial instruments as and when needed and hence facilitate liquidity. Liquidity refers to how conveniently a financial asset can be converted into cash. This is an important function performed by financial markets as there can be situations wherein investors might be compelled to sell their financial instruments for meeting their finance and other needs and in the absence of liquidity they have to hold financial instruments till maturity period and thus depriving them of the benefit of the financial instrument they possess.

(3) Reducing Transaction Costs: Financial markets reduce costs spent on acquiring information about financial instruments as financial markets provides an organized platform wherein parties to trade (investors, borrowers and lenders) come together and share information about financial products and services which can be used by users of financial services/instruments for their financial purposes.

In addition to the above functions, financial markets also provide facilities for interaction between the investors and borrowers by providing them an organized platform where the information relating to characteristics and nature of financial instruments can be easily shared between borrowers and investors.

13.2 TYPES OF FINANCIAL MARKET

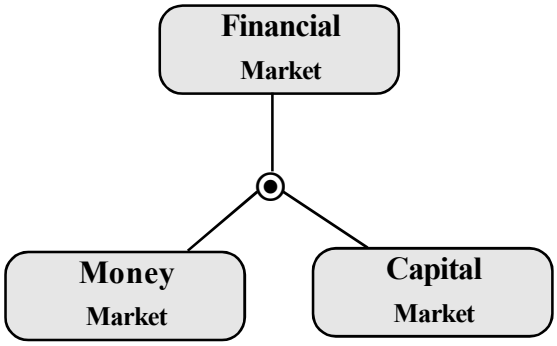


Fig. 13.2 Types of Financial Market

A financial market consists of two major segments:

(a) Money Market

(b) Capital Market

While the money market deals in short-term funds, the capital market handles the medium term and long-term funds.

Evolution and Journey of Money Market in India

The foundation of modern banking in India was started with the setting up of three presidency Banks- Bank of Bengal (1806), Bank of Bombay (1840) and Bank of Madras (1846) which was finally amalgamated to form Imperial bank of India (presently known asstate bank of India). The foundation of banking in India paved the way for origin of money markets in India. The money market in India the then was highly unorganised and scattered in nature until the setting up of Reserve Bank of India in 1935. Post independence (in the year 1947) the number of players in money markets such as commercial banks, life insurance companies, princely states and private trusts were active participants. In the post-independence era and before the onset of early nineties, the money market had components such as call money market, commercial bills market, treasury bills market, intercorporate and inter-bank term deposits. With the financial reforms made in 1990s, money markets in India witnessed deregulation in interest rate structures, removing of ceiling on interest rates, reduction in statutory liquidity ratio (SLR) requirements, introduction of commercial paper and money market mutual funds (MMMFs). Thus from having an unorganised structure in 1950s and to being an underdeveloped market in 1960s-1970s, the money market began to assume an organised shape and formal structure with the onset of 1990s that is the post economic reform period in India.

13.3 MONEY MARKET

The money market is a market for short-term funds, which deals in financial sets/ instruments whose period of maturity is less than or upto one year. It should be d that money market does not deal in cash or money as such but simply provides a market for short term credit instruments such as bills of exchange, promissory s, commercial paper, treasury bills, etc. These financial instruments are close substitutes of money. These instruments help the business units, other organisations and the government to borrow the funds to meet their short-term financing requirements. The most active participants in money markets are commercial banks and other financial institutions.

Money market does not imply 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 (RBI) is the regulator 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.

13.3.1 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 requirements 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 issued by the RBI to meet the short-term requirement of funds. Treasury bills are highly liquid instruments, which mean, at any time the holder of treasury bills can transfer or get it discounted from RBI. Treasury bills were first introduced in India in October 1917. 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 secure instruments and are issued for a period of not exceeding 364 days. Banks, Financial institutions and corporations normally play a major role in the treasury bill market. For example on 1st March 2018 Ramesh paid Rs.9200 to buy a one year (or 52 week) treasury bill and on 1st March 2019 the treasury bill was redeemed for Rs.10000, thus effectively paying Rs. 800 as interest (Rs.10000- Rs.9200). The earnings/yield on such bill stood at 8.69% (Rs.800/Rs.9200) [(interest amount)/ (purchase price)].

(c) **Commercial Paper:** Commercial paper (CP) is a popular instrument for financing working capital requirements of business units, more particularly companies. The CP is an unsecured instrument issued in the form of promissory . 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 players of commercial paper market.

(d) **Certificate of Deposit:** Certificate of Deposit (CD) is a short-term instrument 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 is in immediate need of money he/she can draw a bill of exchange in favour of the buyer. When the 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, these are known as Commercial Bills. So a trade bill is an instrument, which enables the drawer of the bill to get funds for short period to meet the working capital needs.

Name of the instrument	Duration	Issuer
Treasury Bill	Not exceeding 364 days	RBI
Commercial paper	15 days to one year	Highly reputed companies
Call money	1day to fortnight	banks
Certificate of Deposit	91 days to one year	Banks & Special Financial Institutions
Commercial bill	Within 1 year	seller

13.4 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 of various securities such as shares, debentures, bonds, etc. In capital market funds are usually raised for meeting expansion and capital expenditure funding requirements by corporations. Let us discuss about the market for trading of securities.

The market where financial 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 financial securities and is, therefore, also known as new issue market; whereas the secondary market provides a place for purchase and sale of existing financial securities and is often termed as stock market or stock exchange.

13.4.1 PRIMARY MARKET

The Primary Market consists of arrangements which facilitate the procurement of long-term funds by companies by making fresh issue of financial securities (borrowed as well as owned securities). 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 through initial public offerings (IPO) or follow-on public offerings (FPO). 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 IPOs made recently by a number of public sector undertakings such as ONGC, GAIL, NTPC and private sector companies like Tata Consultancy Services (TCS), Biocon, Jet-Airways and so on.

13.4.2 SECONDARY MARKET

The secondary market also 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 undue 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. In the secondary market you have all these and the stockbrokers who are members of the stock exchange who facilitate trading. After having a brief idea about the primary market and secondary market let see the difference between them.

13.5 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 corporations/companies, stockbrokers who are members of the stock exchange.

3. **Listing Requirement:** For securities to be traded in stock market, their listing is mandatory while for primary market issues there are no such requirements.

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.

A Brief History of Stock Exchange in India

The history of stock exchanges in India can be traced to 18th century when securities (shares/ debentures) of East India Company were being traded mainly in the cities like Mumbai and Kolkata. However growth in stock market activities was observed after passing of Companies Act 1850 which introduced joint stock companies with limited liability. This period also observed rapid growth in the number of business enterprises set up as well as production also gone up. This period also saw setting up of first stock exchange which was Bombay Stock Exchange in 1875. Post I dependence in 1947, stock markets in India saw limited activity as role of financial system/institutions were limited. During the 1950s and 1960s there was not much development in stock market because of weak industrial base and low savings rate. However, this period saw various regulations enacted to support and promote stock market activities the positive results of which started coming out in 1970s and by 1980s, number of stock exchanges in India rose significantly. With the onset of 1990s, several reforms were made in stock markets with the repeat of Capital Issues (Control Act) 1947 and setting up of SEBI in 1992 as overall regulator of stock markets in India. After the formation of SEBI, stock market has gone through various transformations and has handled large volumes of transactions.

13.6 DISTINCTION BETWEEN CAPITAL MARKET AND MONEY MARKET

1. **Period of Funds:** Money market is related to short-term funds while the capital market is related to medium and long-term funds.

2. **Nature of Securities:** Money market deals in securities like treasury bills, commercial paper, trade bills, deposit certificates, etc. On the other hand, the capital market deals in shares, debentures, bonds and government securities.

3. **Participants:** The participants in money market are commercial banks, nonbanking financial companies, etc., while the participants in capital market are stockbrokers, underwriters, mutual funds, financial institutions, and individual investors.

4. **Regulator:** Money market is regulated by Reserve Bank of India while the Capital market is regulated by Securities Exchange Board of India (SEBI).

13.7 STOCK EXCHANGE

As indicated above, stock exchange is the term commonly used for a secondary market, which vides 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 define dassisting, regulating and controlling business of buying, selling and dealing in securities stock exchange as an " association, organisation or body of individuals, whether r incorporated or not, established for the purpose". Considering the role played by stock exchange in the economic growth of the country it is often referred as barometer of the economic health/situation of the country.

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.

13.7.1 FUNCTIONS OF A STOCK EXCHANGE

The functions of stock exchange can be enumerated as follows:

1. **Provides a Ready Market for Securities:** 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 investors can encash their holdings as and when they want.

2. **Provides Information about Prices and Sales of Securities:** 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 various business TV channels. 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 Securities Dealings and Investment:** Transactions on the stock exchange are conducted only amongst its members with adequate transparency and in strict conformity to its rules and regulations which include the procedure and timings of delivery and payment to be followed. This provides a high degree of safety to dealings at the stock exchange. There is little risk of loss on account of non-payment or non-delivery. Securities and Exchange Board of India (SEBI) also regulates the business in stock exchanges in India and the working of the stock brokers.

   Not only that, a stock exchange allows trading only in securities that have been listed with it; and for listing any security, it satisfies itself about the genuineness and soundness of the company and provides for disclosure of certain information on regular basis. Though this may not guarantee the soundness and profitability of the company, it does provide some assurance on their genuineness and enables them to keep track of their progress.

4. **Facilitates 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 exchange provides 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 depression. Thus, the intensity of trading at stock exchanges and the corresponding rise or 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. **Efficient 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.

13.7.2 ADVANTAGES OF STOCK EXCHANGES

Having discussed the functions of stock exchanges, let us look at the advantages of stock exchanges 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 there of 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.

13.7.3 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. Excess speculation may drive the stock markets into instability mode which is harmful for the economy.

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.

13.8 SPECULATION IN STOCK EXCHANGES

The buyers and sellers at the stock exchange undertake two types of operations, one of speculation and the other of 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, these 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 etlement 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. She 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 She is has a yee 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'. In India, rolling settlement was introduced in Indian equity market from 1st April 2003.

Today, with the electronic / computer based system of recording and carrying out of share transactions, stock exchanges go in for 'rolling settlement'. That means, transaction are settled after a fixed number of days of the transaction rather than on a particular day of the week. For example, if a stock exchange goes in for 'T+2' days of rolling Settlement the transaction is settled within two working days of occurring of the transaction, 'T' being the day of the transaction. In T+7' days of rolling settlement, the transaction Is settled on the 7th day after the transaction. This is facilitated through electronic transfer of shares, through Dematerialised Account or Demat Account i.e., the share does not have a physical form of a paper document, but is a computerised record of a person holding a share, and through transfer of money electronically or through cheques payment is settled.

Though speculation and investment are different in some respects, in practice it is difficult to say who is a genuine investor and who is a pure speculator. Sometimes even a person who has purchased the shares as a long-term investment may suddenly decide to sell to reap the benefit if the price of the share

goes up too high or do it to avoid heavy loss if the prices starts declining steeply. But he cannot be called a speculator because his basic intention has been to invest. It is only when a person's basic intention is to take advantage of a change in prices, and not to invest, then the transaction may be termed as speculation. In strict technical terms, however, the transaction is regarded as speculative only if it is settled by receiving or paying the difference in prices without involving the delivery of securities. It is so because, in practice, it is quite difficult to ascertain the intention.

Some people regard speculation as nothing but gambling and consider it as an evil. But it is not true because while speculation is based on foresight and hard calculation, gambling is a kind of blind and reckless activity involving high degree of chance element. Not only that, speculation is a legal activity duly recognised as a prerequisite for the success of stock exchange operations while gambling is regarded as an evil and a punishable activity. However, reckless speculation may take the form of gambling and should be avoided.

13.9 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 Security Contracts (Regulation) Act was passed in 1956 for recognition and regulation of Stock Exchanges in India. At present we have 7 stock exchanges in the country. Of these, the most prominent stock exchange that came up is National Stock Exchange (NSE). It is 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. One of the most notable feature which as found in stock exchanges belonging to pre-independence period was of using o en outcry system/method for buying and selling of securities. In open outcry system buyers and sellers of securities faced each other and information was exchanged. In this system, interested parties employed verbal and hand signal communication for trading and pricing of securities.

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.

13.10 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 delete space for recognition of stock exchanges by the Central Government. It had 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.

13.11 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;

(b) promoting the development of securities market;

(c) regulating the securities market and

(d) matters connected therewith or incidental there to.

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 (now capital Issues (Control) Repeal Act, 1992) and the Securities Contracts (Regulation) Act, 1956 as may be delegated to it by the Central Government.

As part of its efforts to protect investors' interests, SEBI has initiated many primary market reforms, which include:

1. Improved disclosure standards in public issue documents,

2. Introduction of prudential norms and simplification of issue procedures.

3. 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.

4. SEBI has also introduced a code of advertisement for public issues for ensuring fair and truthful disclosures.

5. 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.

6. 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 undersubscribed 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.

7. 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. 8. 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. SEBI defines book building as a process undertaken by which a demand for securities proposed to be issued by a body corporate is elicited and build-up and the price for such securities is assessed for the determination of the quantum of such securities to be issued by means of a notice, circular, advertisement, document or information memoranda of offer document."

As for measures in the secondary market, it should be d 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. Measures in the secondary market are:

1. 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.

2. It has issued guidelines for composition of the governing bodies of stock exchanges so as to include more public representatives.

3. Corporate membership has also been introduced at the stock exchanges.

4. It has notified the regulations on insider trading to protect and preserve the integrity of stock markets and issued guidelines for mergers and acquisitions.

5. 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.

6. To prevent excessive speculations and volatility in the market, it has done away with bad la system, and introduced rolling settlement and trading in derivatives

7. All stock exchanges have been advised to set-up clearing corporation / settlement guarantee fund to ensure timely settlements.

8. SEBI organises training programmes for intermediaries in the securities market and conferences for investor education all over the country from time to time.

13.12 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 provides 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.

13.12.1 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 carry over basis (bad la).

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.

13.13 DEPOSITORY SERVICES

The Depositories Act 1996, introduced the depository service system in India. Under the depository system, physical securities are converted into electronic form through 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 open 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.].

13.13.1 SERVICES PROVIDED BY DEPOSITORY

1. Dematerialisation (demat) that is converting physical certificates into electronic form.

2. Dematerialisation (demat) that is getting physical certificates from the electronic 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.

13.13.2 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.

TERMINAL EXERCISE

Very Short Answer 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.
6. What do you mean by 'Depository'?

Short Answer Questions

1. Define money market and explain its importance in a modern economy.
2. What is capital market? How does it differ from money market?
3. Distinguish between primary market and secondary market.
4. How does the stock exchange help in mobilizing savings and capital formation?
5. Describe the measures taken by SEBI to regulate the secondary market.
6. What is meant by a 'Demat' account?
7. Anil wants to invest money in share market. As a financial advisor what will you suggest him to do?

Long Answer Questions

1. Define stock exchange and explain its functions.
2. Explain the importance of stock exchanges from the point of view of companies and investors.
3. Explain the role played by SEBI in protecting investors' interests and controlling the business at stock exchange.
4. Give explanatory s on (a) stock exchange in India; and (b) Regulations of stock exchanges.
5. Describe the two components of the securities market in detail.

Module 4
Trade

14. INTERNAL TRADE

You may be consuming a variety of products in your daily life - a book, a pen, soap, garments, vegetables and fruits to mobile phones, radio, television, fans and furniture. Where do you go to 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 to get more variety or better priced products. Now the question that arises is, how do all these products reach the market? There are a number of firms/people who are engaged in this activity of bringing the product from the place of production to the market and then making it available to the final consumers. They act as a link or intermediary 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 the consumers to buy the products for their consumption.

LEARNING OUTCOMES

After studying this lesson, you will be able to:

- describes the important role played by internal trade in business;
- distinguishes between the different types of middlemen and the role played by them.
- differentiates between the various types of retail stores and their importance; and
- explains the different trends of distribution and their significance in internal trade.

14.1 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 salient features.

Features of Internal Trade

(a) The buying and selling of goods takes place within the boundaries of the home (domestic) 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.

14.2 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 demand. 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 others buy in bulk and sell in small quantities as per the demand of the customers. Thus, on the basis of volume of goods traded we can classify internal trade as:

1. Wholesale trade 2. Retail trade

14.2.1 WHOLESALE TRADE

Wholesale trade refers to buying of goods in large quantity from producers or manufacturers 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 only one or a few products.

Functions of the Wholesalers

1. **Procurement of Goods:** The wholesalers purchase goods from different manufacturers and hold sufficient stock.

2. **Grading and Packing:** The wholesalers divide the goods according to their size,weight, shape and quality. In this way they prepare the goods in small lots for sale to retailers.

3. **Transporting:** The wholesalers transport the goods from the production centres to their godowns and from there to the retailers. Some wholesalers have their own vehicles for transportation of goods.

4. **Warehousing:** The wholesalers keep the stock for retailers in the warehouse so as to make goods available to the retailers whenever they need them.

5. **Financing:** The wholesalers buy goods from the manufacturers and sometimes 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:** The wholesaler bear the risk of changes in demand during storage.They also bear the risk of damage of goods, risk of bad debt etc.

7. **Providing Market Information:** The wholesalers 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 needs and demand of the consumers.

8. **Selling:** Retailers are widely scattered all over the country. Many wholesalers employ sales persons to take orders from the retailers. Thus, the wholesalers help in selling goods.

Services Provided by the Wholesalers

Wholesalers provide services to the manufacturers and the retailers.

1. **Services to Manufacturers :** Wholesalers render the following services to the manufacturers :

   a) **Bulk Buying:** Wholesalers collect orders from a large number of retailersand 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:**The 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.

   b) **Financial Help:** The 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 run the business properly.

   c) **Advertisement:** The wholesalers advertise their goods regularly so the process of selling goods becomes easy for the retailers.

   d) **Market Information:** The wholesalers provide up-to-date information about new products to the retailers. The wholesalers advice retailers on matters like price, quality and time of purchase and sale.

   e) **Risk Protection:** The wholesalers keep huge stock of goods and sell to retailers on credit. As a result, retailers have to bear less risk.

14.2.2 RETAIL TRADE

Retail trade refers to buying goods from the manufacturers or wholesalers and selling the same to the final 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 demand of the 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 or near the main markets.

(d) Generally retail trade involves buying on credit from the wholesalers and selling for cash to the consumers.

(e) A retailer has indirect relation with the manufacturer (through the wholesalers) but a direct link with the consumers.

Services Provided by Retailers

Retailers provide the following services to the consumers and wholesalers:

1. Services to 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 a wide variety of products. Consumers like to purchase all products from the same shop. So, retailers stock products of different companies providing a wide choice to the consumers.

d) Home Delivery: Some retailers supply goods to the homes of consumers without any extra charge.

e) Consumer Education: When a new product comes in the market, retailer clearly explains the features, merits and uses of the product to the final consumers.

2. Services to the Wholesalers

a) Market Information: Retailers supply valuable information to the 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 a number of consumers.

c) Large Scale Production: Retailers help manufacturers operate at alarge scale.

d) Sell New Products: New products will be displayed in retail outlets in an attractive manner so as to persuade consumers to buy these products.

14.3 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 of products.

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

products to a large extent. The responsibility of the producer gets limited to producing the product. Largely all efforts to sell and distribute the same are taken up by these middlemen. For the consumers too, these middle men 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 the wholesalers and retailers in the chain of distribution.

14.3.1 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 the 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 their transportation.

(b) Role of the 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 procured from different locations. The retailers may offer credit facility to the customers. They also offer pre-sales and after-sales services and communicate to the 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 the feedback or consumer's response to the product.

14.3.2 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 in return for the product 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. 3.50 that has added considerably to the price of the product.

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 the producers and the consumers. To that extent, they are justified to get their share of profit in the sale of the product. But it should be reasonable and not too high so as to become a burden on the consumers.

We must also consider some of the problems that arise from the presence of middlemen in the chain of distribution. If there are too many middlemen between the manufacturers and the consumers, each charging his share of profit or commission, the final 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 producers. 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.

14.3.3 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 to the retailers.	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 products.	Located near residential areas.
8. Display	Does not require elaborate display of goods.	Requires attractive display of Products.

14.4 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 retail business.

We can classify the retail business on the basis of size as small scale, medium scale and large scale. 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 retail business is whether they have any fixed place of business or not.

On this basis, one can have two categories of retail business:

1. Itinerant Retailing 2. Fixed shop Retailing

14.4.1 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.

1. 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 bazaars".

2. 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.

18.4.2. 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 understand the details of these stores.

(i) General 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.

Fig. 14.1 General Store

(ii) Single Line Store

These stores deal with a specific line of goods. You must have seen medicine shops, bookshops, toy shops, readymade, 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.

Fig. 14.2 Second-hand Goods Shop

(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 to the doorstep of the customers.

Types of Large-scale Retail Trade

In India, generally we find the following types of Large-scale Retail 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 detail all these types of retail trade.

(i) Departmental Stores

Departmental Store is a large-scale retail shop where a large variety of goods are sold in a single building.

Features of Departmental Store

i. The entire building is divided into a number of departments or sections.

ii. In each department specific type of goods like stationery items, books, electronic goods, garments, jewellery etc. are made available.

iii. 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.

iv. To encourage people to do all their shopping in one store, these stores also provide facilities like restaurant, telephone, toilet, ATM etc., for the convenience of customers.

v. These stores also provide the facility like free home delivery of goods, execution of telephonic order for goods, credit facility, etc.

vi. 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.

vii. Big Bazar, Vishal Megamart, Ebony, Shoppers' stop are some of the leading departmental stores in our country.

Fig. 14.3 Departmental Store

Merits of Departmental Stores

(a) They sell a large variety of goods to the 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 the manufacturers, and get good amount of discount from them. They are able to reap the benefits of the economies of scale with reference to 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 .

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 a large number of employees and provision of various facilities for the convenience of customers.

(d) There is no direct contact between the owners and customers in departmental stores. It is the employees of the store who interact with the customers. The owners do not get first hand information about the taste, 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 attracted 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, Haldiram, Domino etc. These are multiple shops.

Features of Multiple Shops:

i. They sell similar range of commodities at the same price in all their shops.

ii. These shops are usually owned and run by big manufacturers/producers.

iii. 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'.

iv. Multiple shops deal with similar types of goods mostly of everyday use e.g., shoes, textiles, watches, automobile products, etc.

v. The price is uniform for similar items in all the shops.

vi. These shops are usually conveniently located in the main market place or in busy shopping centre.

Merits of Multiple Shops

The multiple shops offer the following advantages to buyers and sellers. Let us learn about them:

(a) All multiple shops are often built alike, that helps customers to recognise these 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 do not arise in these shops. Also, standard quality and uniform price of products help in winning the confidence of the 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 the 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 products 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.

(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 set up 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 the departmental stores, super markets do not

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 needs and bring it to the cash counter, make the payment and take the delivery of the goods.

Merits of Super Markets

Let us understand 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 bazaar.

(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 sold by the 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 stores purchase the goods directly from manufacturers or dealers and make them available at a cheaper price.

Let us learn about the various merits of consumer cooperative stores.

Merits of Consumer Cooperative Stores

(a) The consumer cooperative stores generally provide the goods at a price lower 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 profits 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 the limited income group.

(b) Lack of fund or resources restrict the growth and expansion of business.

(c) These stores are managed by the members who may not have sufficient experience in business management. Again, due to limited funds, it is also not possible to engage professional managers.

(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 places the advertisements in newspapers, magazines, television, social media etc. or publicise 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 which 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 setup 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 productor 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 limitations 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, colour, design etc. from the one that is shown 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 at 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 customers.

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 offraud and other malpractices by certain retailers, customers do not have much faith in mail order retailers. Possibility offraud 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 a 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 nationwide 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 an agreed 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 for 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 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 the 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.

14.5 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 eliminate the long and expensive chain of middlemen. Manufacturers are directly approaching consumers, either through their websites using Internet or through their agents (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, social media) 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-toface 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 the 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 overthe 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.

Nowadays, if a large number of customers are to be approached through telemarketing; computerised calling system is used instead of a person calling up customers. The desired telephone numbers are dialled mechanically and the computer plays a prerecorded 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.

14.5.1 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 to 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 conveniences 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, packed food products (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 for purchase of 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 provide They are generally designed in such a way that they are accessible to the differently abled persons also 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 preferences.

14.5.2 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 promotes the growth of commerce and industry in a particular region or country. This is a non-profit making organisation.

14.5.3 DOCUMENTS USED IN INTERNAL TRADE

Following documents are used in internal trade :

1. **Proforma 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 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 :** 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 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 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 :** 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 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 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.

14.5.4 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.

14.5.5 TERMS OF TRADE

i. **Cash on Delivery (COD):** It is a type of transaction in which payment for goods is made at the 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 includes all charges at the post of shipment upto the loading of goods on board the ship and export duty, if any.

iii. **Cost Insurance and Freight (CIF):** This includes the cost of goods, all expenses incurred for taking the goods to the port of destination and insurance charges.

iv. **Errors and Omissions Excepted (E & OE) :** It is an expression that is used as a disclaimer against clerical errors.

TERMINAL EXERCISE

Very Short Answer 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 Questions

1. Explain the role of wholesaler in the distribution channel.
2. State any four merits of departmental stores.
3. Give any four points of distinction between a retailer and a wholesaler.
4. Explain the merits of super markets.
5. What is meant by 'mail order retailing'?

Long Answer Questions

1. State the features of departmental Stores. How is a departmental store different from multiple shops?
2. Describe the role of middlemen in the channel of distribution.
3. What is meant by Consumer Cooperative Store? Explain its merits in brief.
4. Explain the features of Franchise as a form of large scale retailing business.
5. Describe in brief the recent trends in distribution.

15. 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 countries across the globe. Today, we can buy goods of our need from other countries and also sell our surplus goods abroad without facing any 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. External trade also facilitates efficient allocation of resources. 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.

LEARNING OUTCOMES

- explains what is external trade and its importance for business;
- identifies the challenges faced by external trade from a business prospective;
- distinguishes between export and import trade procedures; and
- identifies the various measures adopted to promote export in the economy.

15.1 EXTERNAL TRADE - MEANING

You know that no country in the world possesses everything needed by its people. So they all have to depend on other countries of the world 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 gives 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.

15.2 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 these in detail.

(a) Import Trade: When the business firm of a country purchases goods from the firm of another country, it is called Import trade. For example, when Indian government 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 the 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.

In India formulation of policies concerning external trade comes under the authority of Ministry of Commerce and Industry.

A country cannot import goods directly from others because of the following reasons:

- Non-accessibility of Trade Routes: The exporting country may not have any accessible trade routes connecting the importing country; or
- Processing/Finishing Required: The goods imported may require processing or finishing before exporting. And these facilities may be lacking in the exporting or importing countries;
- Lack of Trade Agreement: There may not be any trade agreement between both the countries. Let's understand this, Thailand, Japan and India are Asian countries. Thailand imported electronic goods from Japan and exported it to India as the latter does not have any trade agreement with Japan. In this example Thailand carried out "enterpot" trade.

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. Visible trade is also known as merchandise trade.

15.3 IMPORTANCE OF EXTERNAL TRADE

External Trade is an important indicator of the economic condition of a nation. Both importing and exporting countries are benefitted 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 detail 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 and competency 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 in 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 of country.

Tracing the History of External Trade in India

In India, external trade as a concept dates back to as old as Indus valley civilization (3300-1300 BCE) wherein the traders carried out trade with contemporary civilizations like Babylon, Mesopotamia and Persia. They exchanged goods like gold, silver, copper and turquoise. There are evidences which exhibit that Harrapan era traders participated in maritime trade network spanning from Central Asia to modern day West Asia such as Iraq, Iran, Kuwait and Syria. In the modern day Iraq (ancient Mesopotamian civilization), archaeological sites have found Harappan seals and jewellery. The period of early Harappan period (3200-2600 BCE) also showed cultural similarities when it comes to designs of pottery, seals, figurines and ornaments between Harappan and Central Asian civilizations. Some of the Harappan sites like Lothal, Surkotada and Balakot were important trading coastal cities which were facilitating external trade. In the Lothal site of Harappan civilization a circular buttoned seal from Persian Gulf had been found which indicates that trade links existed between these two coastal cities.

(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 other countries of the world.

(f) **International Relations:** External trade brings the people of two different countries to come closer and to understand the need and requirement of each other. International trade leads to cultural and trade related exchanges. All these activities promote harmonious and cordial relations among the nations.

(g) **Economic Growth:** Economic growth of every country depends to a large extent 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) **Efficient Utilisation of Natural Resources:** External trade is a means through which the natural resources of various countries can be efficiently and 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.

15.4 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 carrying out foreign trade. The various difficulties, which are faced by the buyers and sellers engaged in external trade are described as follows:

(a) **Geographical 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) **More Risky in Nature:** In external trade goods are exposed to greater degree of risk.Risk in transit of goods is more because of long distance. Transit of goods may be affected due to poor weather, enemy actions, sea pirates though some of these risks can be covered and mitigated through insurance coverage but it inflates the cost of goods shipped. Risks in foreign trade also arise out of instability in exchange rates.

(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 cannot 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) **Legal and Custom Related 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) **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.

(f) **Change in Rules and Regulations:** Every country has framed its own rules and regulations for its external trade in order to protect its economic and political interests. 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.

(g) **Fluctuations in Exchange Rate:** One of the greatest risks associated with external trade is that prices of products is subject to movement in the exchange rate of the countries which changes frequently-followed by either appreciation or deprecation in the value of currency of any country. Taking into account ever changing currency fluctuations,is a difficult task for business firms.

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 75.64 INR as on June, 26, 2020. 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 _____. In India foreign exchange rate management comes under the authority of RBI.

15.5 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 carry out 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 state trading corporations (STC), Minerals and Metals Trading Corporation (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 (warehouse) of the exporter to the godown of the importer.

7. **Trade Commissioners:** These officials are appointed by the government in their embassies 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 matters.

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 bythe 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):** The Government provides certain facilities and benefits to the exporters and importers under its EXIM policy. To avail such facilities every firm must obtain the Registrationcum- 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.

15.6 PROCEDURE FOR EXPORT TRADE

The general procedure adopted for exporting goods to a foreign country is as follows:

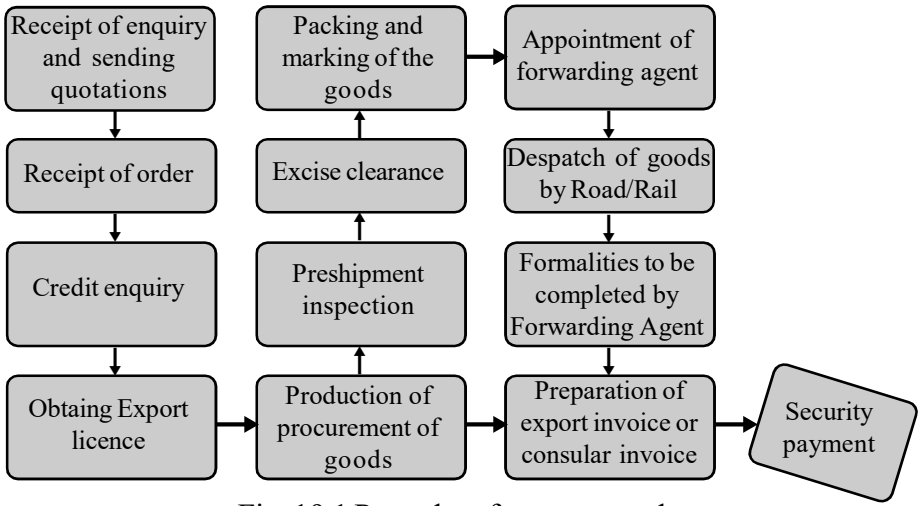


Fig. 19.1 Procedure for export trade

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.

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 Export-Import Code (IEC) number (ii) Registration Cum Membership Certificate (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 preshipment 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 must for the goods to be exported. It may be d 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 to be shipped 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 customhouse. 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 canbe 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.

15.7 PROCEDURE FOR IMPORT TRADE

The steps involved in importing goods are discussed below:

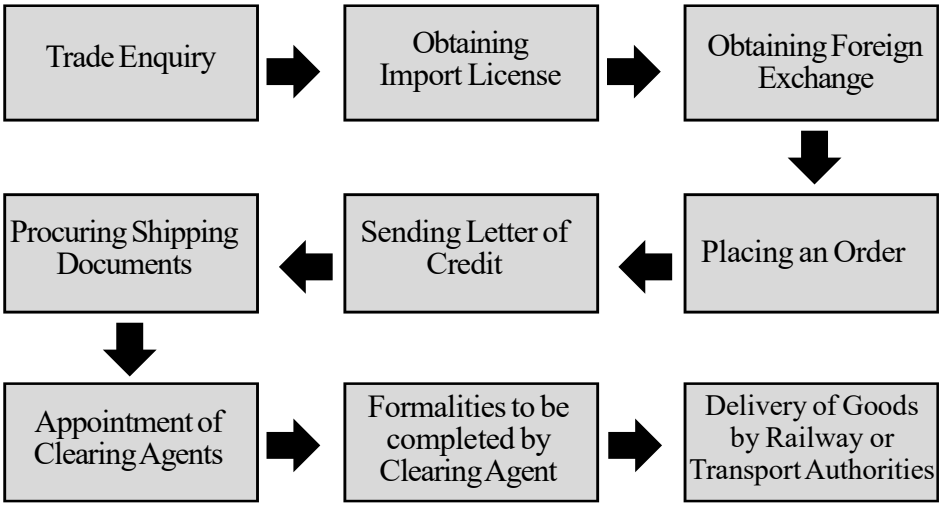


Fig. 19.2

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 avalid licence from the Import Licensing Authority. In India it is compulsory to get the IEC number from the Directorate General of Foreign Trade (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 along with two copies of Bill of entry to the custom office. If custom duty is to be paid, he will make the payment and take delivery of the goods. Dock charges are defined as charges which are being paid to concerned port by a shipping company using for loading and unloading of 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 is 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.

15.8 DOCUMENTS USED IN EXTERNAL TRADE

The main documents which are used in external trade are discussed below:

1. **Indent:** It is an official order or requisition 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 instructions regarding shipment and insurance, etc.

2. **Letter of Credit:** In external trade, the importer has to prove his creditworthiness 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 document

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 lots, he has to present the bill of entry for warehousing. The reason could be 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.

15.9 WORLD TRADE ORGANISATION

The Eighth Uruguay Round was successful and led to the setting up of the World Trade Organisation (WTO). The WTO was launched on January 1, 1995 replacing the General Agreements on Trade and Tariffs (GATT). Naturally, the GATT members became the members of WTO. It administers the agreements contained in the Final Act of the Uruguay Round.

As on December 2017,WTO has 164 members. WTO is headquartered at Geneva, Switzerland.

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, which 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. India has been a member of WTO since January 1, 1995 and member of GATT since 8th July 1948. Before we proceed further, let's learn some key differences between GATT and WTO which can be summarized as follows:

1. **Conceptual Framework:** GATT was basically a set of rules and regulations for multilateral trade agreements with the objective of promoting international trade while WTO is an institutional mechanism which attempts to regulate, monitor and liberalize international trade.

2. **Institutional Existence:** GATT does not have any institutional existence while WTO bears permanent institutional character with functioning secretariat.

3. **Nature of Participation:** In case of GATT participating nations were contracting parties while WTO has membership for nations.

4. **Scope of Application of Rules and Regulations:** The rules and regulations pertaining to GATT were applicable for goods only while in case of WTO it extends to both goods and services.

Objectives of WTO

i. Raising standard of living

ii. Employment generation.

iii. Optimal use of world resources.

iv. Promoting sustainable development.

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 trade and non-trade 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.

TERMINAL EXERCISE

Very Short Answer 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 Questions

1. Explain 'packing and marking' of the goods in external trade.
2. Explain the two alternative methods of payment to the exporter.
3. What is meant by 'Letter of Credit'?
4. What are (i) Bill of Lading, (ii) Shipping order and (iii) Mate's receipt.

Long Answer questions

1. Explain the various measures taken up by Government of India to facilitate exports.
2. Discuss the various documents used in External Trade.
3. Advise Suresh, the procedure to import ball pens from Japan.
4. Satish wants to export leather goods to Singapore. You are required to explain to him the procedure for the same.
5. Explain the need and importance of external trade to the Indian Economy.

Module 5

Awareness in Business and Employment

16. SELF-EMPLOYMENT

Having learnt about the nature and scope of business, business support services, business environment, forms of business organisations, you may now be thinking about ways to earn your livelihood. At this stage you have to decide whether to take up a job in an organisation or to start your own business venture. When you accept an employment in any organisation, you have to perform various jobs as per the requirements of your employer and you may get a fixed amount of income as salary. But, instead of seeking a job, you can also opt to do work on your own to earn your livelihood. You may run a small retail shop, tailoring shop, restaurant, bakery and confectionery shop, beauty salon, etc. in your locality. In other words, you may get engaged in manufacturing, trading, marketing or selling of products or services on a small scale to earn your livelihood. Such economic activities are known as self employment. An individual can make a very good living out of the income generated from a self employment venture. However, there is a need to plan and select a lucrative venture suitable to the local needs. In this lesson, we will learn more about the career opportunities of self-employment in business.

LEARNING OUTCOMES

- explores the possibility of self-employment and the avenues of self-employment; and
- describes the advantage of government support for small business:

16.1 MEANING OG SELF EMPLOYMENT

You know that earning is necessary for a living. Your father, mother, brothers, sisters and others may be engaged in different economic activities through which they earn their livelihood. Have you ever observed their activities? What exactly do they do?Possibly some of them may be working for others in factories, shops, agricultural fieldetc. and get a fixed amount from their employers for the service rendered by them.These persons are engaged in an economic activity which is termed as wage employmentor paid employment. But there are many persons who engage themselves in oneoccupation or some business which they start and manage on their own instead ofworking for a wage or salary in an organisation run by others.They put in their besteffort and take all types of risks to pursue their careers successfully. The entire earningof their work goes to them. All of us have seen small grocery shops, tailoring shops,medical stores etc. in our locality. These are owned and managed by a person, with orwithout the help of some assistants. Their economic activities are termed as selfemployment.So when an individual engages in any economic activity and manages iton his own, it is known as self-employment.

Thus, self-employment may be defined as, an economic activity which one may performon his own as a gainful occupation. Self-employment may consist of producing andselling goods, buying and selling goods, or rendering services for a price by taking therisk to mobilize inputs and other resources.

From the above discussion we can analyse the characteristics of self-employment.

16.2 CHARACTERISTICS OF SELF EMPLOYMENT

Following are the characteristics of self-employment:

1. Self-employment involves doing something on one's own to earn one's livelihood.

2. It involves ownership and management of activities by a person although he/she may take the help of one or two persons to assist him/her. Thus, self-employment may provide employment to other persons as well.

3. The earning from self-employment is not fixed. It depends on the income one can earn by producing or buying and selling goods or providing services to others at a price.

4. In self-employment, the owner alone has to take the profit and bear the risk of loss. So, we find a direct link between the effort and reward in self-employment.

5. It requires some amount of capital investment, although it may be small.

6. In self-employment, a person is free to take decisions in respect of running his business profitably and avail of any opportunity that may come up for expansion of his business.

7. It gives complete freedom to work as per one's own will and within the parameters of the prevailing legal regulations.

16.3 IMPORTANCE OF SELF-EMPLOYMENT

Career is a way of making one's livelihood. Self-employment is also a career becauseone may employ oneself in business or in service activities and earn one's livelihood.With growing unemployment and lack of adequate job opportunities, self-employmenthas become very significant.

The share of the self-employed in the workforce according to the PeriodicLabour Force Survey (PLFS) of 2017-18, remained stagnant between 2011-12 and 2017-18 at 52.2%, The share of the self-employed in the workforcewas high among some of India's poorest states: Chhattisgarh (66%), Rajasthan(65%), Uttar Pradesh (64%), and Jharkhand (61%)Its importance can be enumerated as follows

1. **Advantages of Small Business:** Small-scale business has several advantagesover large-scale business. It can be easily started, and requires small amount ofcapital investment. The self-employment involving activities on a small-scale is agood alternative to large scale business which has brought various evils likeenvironmental pollution, development of slums, exploitation of workers, and soon.

2. **Preference over Wage Employment:** In self-employment there is no limit ofearnings as is the case with wage employment. In self-employment one can useone's talent for own benefit. The decisions can be taken quickly and conveniently.All these factors act as strong motivators for self-employment to be preferredover wage employment.

3. **Developing the Spirit of Entrepreneurship:** Entrepreneurship involves takingrisks because the entrepreneur tries to innovate new products, new methods ofproduction and marketing. Self-employment, on the other hand, involves eitherno risk or very little risk. But, as soon as the self-employed person starts becominginnovative and takes steps to expand his business, he becomes an entrepreneur.Therefore, self-employment becomes a launching pad for entrepreneurship.

4. **Promotion of Individualised Services:** Self-employment may also take theform of providing individualised services like tailoring, repair work, dispensingof medicines etc. Such services are helpful in providing better consumersatisfaction. These can be easily started and run by individuals.

5. **Scope for Creativity:** It provides opportunity for development of creativityand skills in art and crafts, leading to preservation of the cultural heritage ofIndia. For example, we can see creative ideas reflected in handicrafts, handloomproducts, etc

6. **Reducing the Problem of Unemployment:** Self-employment providesopportunities of gainful occupation to those who otherwise remain unemployedand helps to empower them financially. Thus it reduces the problem ofunemployment.

7. **A boon to Under-privileged in Respect of Higher Education:** Everyonemay not be able to pursue higher education after Secondary or Senior Secondaryexamination due to one or the other reason. Such persons can start their careeras self-employed in occupations that do not require higher education.Self-employment is large in India also because government policies and programmesencourage owner-managed small and medium enterprises.A number of schemes havebeen initiated all over the country to encourage entrepreneurship and self-employment.

16.4 AVENUES OF SELF-EMPLOYMENT

The Indian Government through its constant efforts towards development of agriculturaland industrial economy has been able to generate numerous self-employmentopportunities for the people. However, before choosing a suitable career in selfemploymentyou must have some idea about the avenues in which self-employmentopportunities are available.Let us categorise the avenues of self-employment into the following broad areas.

1. Trading;
2. Manufacturing;
3. Professionals; and
4. Individualised services.

Let us discuss further about all these areas:

1. **Trading:** You know that trade involves buying and selling of goods and services.With small amount of investment one can start and run a small trading unit. Youcan think of starting a small grocery or stationery shop in your locality. If you areable to invest more capital and ready to take risk, then wholesale business is agood option for you. One can also take up some agency business or become astockist. The real estate business which is booming now-a-days can also be alucrative alternative.

2. **Manufacturing:** One can start a small industry of manufacturing bricks, orproducing bakery items or confectionery. All these businesses require smallamount of capital and simple equipment. Farming is another such area in whicha person can work all alone or take the help of one or two persons. This is anage-old area of self-employment. Orchards, dairy, poultry, sericulture, fisheries,horticulture, etc. are good examples of avenues of self-employment.

3. **Professionals:** Occupations that require special knowledge and training in aparticular field also provide opportunities of self-employment. Lawyers, doctors,chartered accountants, architects and journalists fall in this category. Howeverone has to follow certain code of conduct framed by their association and getspecialised knowledge and training

4. **Individualised Services:**Tailoring, motor repairing, hair cutting, fashiondesigning, interior decoration etc. are some of the business activities which provideindividualised services to the consumers. These can be easily started and run byindividuals. These activities are based on the personal skills of those who performthem such as the blacksmiths, carpenters, goldsmiths, fashion designers, hairstylist, cartoonist etc. There is freedom to work as and when one wants or needs.

You choose the area of your interest to pursue the career in self-employment. If youdecide to start a small business of your own, you must have complete knowledgeabout the product or service line you choose and the scope and importance of smallbusiness in our country.Additionally, complete information and your understandingabout the government policy and institutional support for its promotion is very essentialfor attaining success in your business.

> According to the Periodic Labour Force Survey (PLFS) of 2017-18 majorityof the self-employed (60%) were engaged in agriculture .and most of thoseengaged in non-agricultural activities were in trade, manufacturing, transportand storage

16.5 MEANING OF SMALL BUSINESS

When somebody questions you, 'what is a small business?', you would probably answer that a business which is:

- small in size,
- requires low capital investment,
- employs small number of workers,

- volume or value of output is low, may be termed as small business.

Yes! You are absolutely right. The size, capital investment, number of employees,volume of output as well as value of output are the most common parameters ofmeasuring a business enterprise.

We may define a small business as a business which is actively managed by its owners, operating within the local area and relatively small in size. However, the Governmentof India has considered the fixed capital investment in plant and machinery asthe only criteria to define a small industrial unit in our country. Up to the year1958, an industrial unit in which fixed capital investment was less than Rs. 5 lakh andemploying up to 50 workers if using power, and up to 100 workers if not using powerwas considered as a small business. This limit has been changed by the governmentfrom time to time.

Under the MSMED Act 2006 on the basis of capital investment made in plant and machinery, excluding investments in land and building -

1. Manufacturing units having investment between Rs 25 lakhs and Rs 5 crores(Rs 50 million) are termed as small enterprises and;2. For service units, having investment between Rs 10 lakhs to Rs 2 crores (Rs 20million) are small enterprises.From the above discussion now we can identify the main characteristics of smallbusiness as:

   (i) A small business is usually owned and managed by one or a few persons.

   (ii) The owners take active participation in day-to-day activities of business.

   (iii) The participation of owners in the management helps in taking quick decisions.

   (iv) The area of operation of a small business is limited. It generally caters to the need of the local people.

   (v) The small business units are generally labour intensive and thus require less capital investment.

   (vi) It generally uses local resources for its operation. The small-scale manufacturing units are usually located near the source of raw material, labour etc.

   (vii) Gestation period (the period that a business waits to get return on its investment) is short.

   (viii) The operation of a small business is flexible. It can easily change its nature, area of operation, process of production etc. as per the change in social, political and economic conditions.

16.6 TYPES OF SMALL BUSINESS

In India we find different types of small business. They may be categorised on the basis of investment in fixed capital in plant and machinery or on the basis of nature orplace of operation. Following are some of the main types of small business.

(a) Small-scale enterprises (b) Micro enterprises

(c) Ancillary industrial undertakings (d) Village industries

(e) Cottage industries (f) trading unit

Let us have a brief idea of the types of small business.

(a) Small-scale Enterprises: According to the MSMED Act 2006Small-scale enterprises are classified into two major categories viz., manufacturing and services.

- Small manufacturing enterprises have investment in plant and machinery of more than twenty five lakh rupees but not exceeding five crore rupees.
- However, investment in equipment is more than ten lakh rupees but does not exceed two crore rupees in small service enterprises.There are about twenty-one major industry groups in the small scale sector.

(b) Micro Enterprises: Under the MSMED Act 2006 on the basis of capital investment made in plant and machinery excluding investments in land and building:

- manufacturing units having investment below Rs 25 lakh (Rs 2.5 million) were termed Micro Manufacturing industries and
- service units, having investment upto Rs 10 lakh (Rs 1 million) were called Micro Service industries

(c) Ancillary Industrial Undertakings: When a small-scale industry supplies not less than 50% of its production to another industry, it is called as ancillary industrial undertaking. The fixed capital investment limit of Rs. One crore also applies to it. If an ancillary unit is owned by some other business unit, it losses it status of small business.

(d) Village Industries: A unit that is located in rural area and which producesgoods or renders service with or without the use of power and in which the fixedcapital investment per head or artisan or worker is specified by the centralgovernment from time to time.

(e) Cottage Industries: These are small manufacturing units producing simpleproducts involving some specific art or skill like handicrafts, filigree etc. Theyuse simple equipments with indigenous technology for production. Cottageindustries are carried on wholly or primarily with the help of members of thefamily either on a whole or part-time basis. These units are not defined on thebasis of capital of investment.

(f) Trading Units: These are usually in the form of small retailers found in the market places.

16.7 IMPORTANCE OF SMALL BUSINESS IN INDIA

Having discussed the meaning, characteristics and different types of small business letus now look at its importance. Small business enterprises are found everywhere. Theyplay a major role in the socio-

economic development of any country. In view of India'sscarce capital resource and abundant labour and natural resources, small-scaleenterprises have been given an important place in the economic planning of the country.In India, small industries account for 95 per cent of the industrial units in the country. InIndia small-scale enterprises account for 35% of the gross value of the output in themanufacturing sector, 80% of the total industrial employment and about 45% of thetotal exports. Besides these contributions, the importance of small-scale business isincreasing day by day due to the following factors.

1. The small business enterprises are capable of generating immediate and largescale employment opportunities in our country.

2. They require less capital investment as compared to large scale business enterprise.

3. The cost of production is less due to use of local resources and fewer establishments and less running cost.

4. The small industries help in effective mobilisation of the untapped resources of the country. With the help of local resources and indigenous technology, worldclass products can be produced by village and cottage industries.

5. Small industries promote balanced regional development of the country. These can be easily set up near the source of resources that leads to overall economic development of that place.

6. The small industries help in improving the national image by exporting quality products to foreign countries. The Indian handicrafts, handloom products, filigree, appliqué works have a high demand in international market.

7. Small enterprises help in raising the standard of living of the people. The people get employment or can start their own enterprises easily. They get a variety of quality products for their daily consumption and use at reasonable prices.

16.8 SCOPE FOR SMALL BUSINESS

The scope for small business is vast covering a wide variety of activities starting from retailing to manufacturing. There are some specific areas of economic activity which can be effectively and successfully managed by forming small business enterprises. Let us now discuss the scope for small business.

1. Trading which involves buying and selling of goods and services requires less capital and time to start. This area of economic activity is dominated by smallscale entrepreneurs.

2. The activities which require personalised service like motor repairing, tailoring, carpentry, beauty parlour etc. are undertaken by persons who establish small business enterprises.

3. For those who do not like to work as an employee the best option is to become self-employed. These people can work independently by running a small enterprise of their own.

4. For products and services, which have low demand or their demand is limited to any specific area, small-scale business is the most suitable.

5. A large industrial unit cannot run smoothly without the support of small units. These industrial units often depend upon the small units (ancillary industrial undertakings) for supplies of some parts or spares, which cannot be profitably produced by them.

6. In the context of business process outsourcing (BPO), many new areas have emerged to offer new opportunities for small business enterprises.

7. The business enterprises, which require constant interaction of the owners with customers as well as the employees, can only be successfully operated in the form of small enterprises.

16.9 GOVERNMENT POLICY TOWARDS SMALL BUSINESS

The Government of India has given special importance to small business enterprises due to their vast potentiality for development of social and economic conditions of the country. Several kinds of assistance and support are announced from time to time keeping in view of the changing economic conditions. The following are some of such steps taken by the Government for development of small business in India.

1. It provides liberalised credit policy like, fewer formalities to process the loans and advances, loans at concessional rate, etc. for small scale industries.

2. To keep away from the competition with large scale industries, the Government of India has reserved about 800 items for exclusive production by small scale industries.

3. The limit for exemption from payment of goods and services (GST) has been raised to 40 lakh turnover for small scale industries from April 1,2019 Under the GST Composition Scheme, small traders and and businesses can pay 1 per cent tax based on turnover of 1.5 crore from April 1 ,2019 against earlier turnover of 1 crore.

4. The Government also gives preference to the products of small enterprises while purchasing stationery and other items for government departments and institutions.

5. For promotion, financing and development of small-scale industrial enterprises several institutes like Small Industrial Development Bank of India (SIDBI), National bank for Agriculture and Rural Development (NABARD), District Industries Centres (DICs) etc. have been set up by the Government.

6. The Government of India has set up separate Ministry of Micro, Small and Medium Enterprises (http://msme.gov.in) for effective planning and monitoring of the development of small business enterprises in the country.

7. To provide benefits of its plans and policies to a large number of Small industries, it has lowered the investment limit from Rs. 3 crore to Rs. 1 crore.

8. The Government provides capital subsidy of 12 % for investment in technology in select sectors of small-scale business.

9. To encourage total quality management (TQM) the Government provides grant of Rs. 75,000 to each unit that obtains ISO 9000 certification.

10. To provide finance, design and marketing support to handloom sector it has launched the Deendayal Hathkargha ProtsahanYojana.

11. The Government of India has permitted upto 24 % of total shareholding of small-scale units by other industrial units.

12. The Government provides land, power and water etc. at concessional rates to small business enterprises.

13. Special incentives are also provided for setting up of small enterprises in rural and backward areas.

14. The Government encourages establishment of small-scale industries by providing developed land and industrial estates.

15. Through the MUDRA scheme of providing capital to the Medium and Small Business Enterprises sector, the government has sought to provide capital to people who wish to start their own enterprises.

16. Some government policies focus on skill building activities under the framework of Skill India Mission that allows self-employed individuals to start more productive jobs.

17. Ministry of Women and Child Development, Government of India launched Support to Training Programme for Women (STEP) to train women in sectors such as agriculture, horticulture, food processing, handlooms, traditional crafts like embroidery, travel and tourism, hospitality, computer and IT services who had no access to formal skill training facilities, especially in rural India.

18. Another government initiative 'Stand-up India' launched in 2015 seeks to provideinstitutional credit to women entrepreneurs, individuals from Scheduled Castesand Scheduled Tribes to set up Greenfield enterprises in manufacturing, servicesor the trading sector. The Stand-Up India portal also acts as a digital platformfor small entrepreneurs and helps to provide information on financing and creditguarantee to them.

16.10 INSTITUTIONAL SUPPORT TO SMALL BUSINESS

To start and run a business enterprise one requires various resources and facilities.These may be in the form of technical, financial, marketing or training support. Suchsupport is provided by the Government by establishing different institutions ororganisations from time to time. Let us now learn about some of such institutions andtheir role in providing support.

1. **National Small Industries Corporation Ltd.:** The National Small IndustriesCorporation Ltd. (NSIC) was set up in the year 1955 to promote, aid andfoster the growth of small industries in India. It provides wide range of promotionalservices to small-scale industries. It

provides machinery to small-scale industriesunder hire purchase schemes and also on lease basis. It helps in export marketingof the products of small-scale industries. It also helps in development andupgradation of technology and implementation of modernisation programme ofsmall-scale industries.

2. **State Small Industries Development Corporations:** The State SmallIndustries Development Corporations (SSIDCs) are set up in various states ofour country to cater to the developmental needs of small, tiny and villageindustries. Their main functions include procurement and distribution of scarceraw materials, supply of machinery on hire purchase basis, and providingmarketing facilities for the products of small-scale industries

3. **National Bank for Agriculture and Rural Development:** The National Bankfor Agriculture and Rural Development (NABARD) was set up in 1982 as anapex institution for financing agricultural and rural sectors. It provides financialassistance through Regional Rural banks and cooperative banks to agriculture,small-scale, cottage and village industries, handicrafts and other allied activitiesin rural areas

4. **Small Industries Development Bank of India:** The Small IndustriesDevelopment Bank of India (SIDBI) was set up in 1990 as a principal financialinstitution for promotion, financing and development of small-scale industrialenterprises. It acts as an apex institution for all banks providing credit facility tosmall-scale industries across the country.

5. **Small Industries Service Institutions:** The Small Industries Service Institutions(SISIs) are set up to provide consultancy and training to small enterprises. Theseinstitutions render technical support service and conduct entrepreneurshipdevelopment programmes. They also provide trade and market information tosmall-scale industries.

6. **District Industries Centres:** For promotion of small industries across thecountry, District Industries Centres (DICs) are set up at district level. Theyconduct industrial potential survey keeping in view the availability of resources.Their main function includes implementation of various schemes of central andstate governments. They appraise the worthiness of various proposals of theentrepreneurs to establish new units, guide them in choosing suitable machinery,equipment and raw materials.

TERMINAL EXERCISE

Very Short Answer Questions

1. What is meant bythe term 'Self-employment'?
2. State any two characteristics of small business.
3. What is micro enterprise?
4. Enumerate the types of small-scale industries found in India.

Short Answer Questions

5. Mention any four characteristics of self-employment.
6. Explain any two avenues of self-employment.
7. State any four characteristics of small business.
8. Describe the role of SIDBI and SISI in providing support to small business in India.
9. What are the areas in which small-scale business enterprises can be successfully established?

Long Answer Questions

10. Explain any four points of significance of self-employment.
11. State and explain any four types of small industries.
12. Describe the various institutional support provided to the small business in India.
13. State any six types of assistance and support provided by the Government of India for development of small-scale business.
14. Describe the importance of small business in India.
15. After passing Class 12, Radha wants to start her own boutique. Her father has promised her to meet her initial financial requirement. She has been advised by her teacher that there are a number of government agencies providing help in various fields and she can approach them. Name such agencies and state the nature of assistance these can provide in starting small businesses.
16. Anil has been observing since his childhood that his father, who is working in a reputed company on a high position, comes from office quite late and exhausted.

Most of the times he is tense because of the pressure of office work so he decides never to go for wage employment. Anil wants to start his own business. Explain to him the various avenues of self employment so that he may understand the advantages and disadvantages of each one of them.

17. JOB EMPLOYMENT

Once you decide to earn your livelihood by pursuing wage employment, you should be ready to work as an employee; work under certain terms and conditions of employment; and get a fixed amount of salary or wages as remuneration. But how will you search for a job and enter into the world of employment? In the current employment situation in our country, it is not an easy task to get into any job. It requires serious preparation in addition to having required qualification and experience for any job You need to find out the vacant position for the jobs in different organisations, prepare and post your resume for the same and be ready to face the employment test and interview. In this lesson you will learn in detail about all these processes.

LEARNING OUTCOMES

- explores various sources of information about job vacancies - print and electronic media, job portals and referencing, Placement agencies-meaning, concept, jobs offered; and
- prepases for Employment- preparing bio-data, preparing for employment test, preparing for interview.

17.1 SOURCES OF INFORMATION ABOUT JOB VACANCIES

You must know some people who are employed in different factories, other business units, and offices. If you ask them as to how did they get the information about those job vacancies in those offices, you will learn that they got the necessary information from various sources.

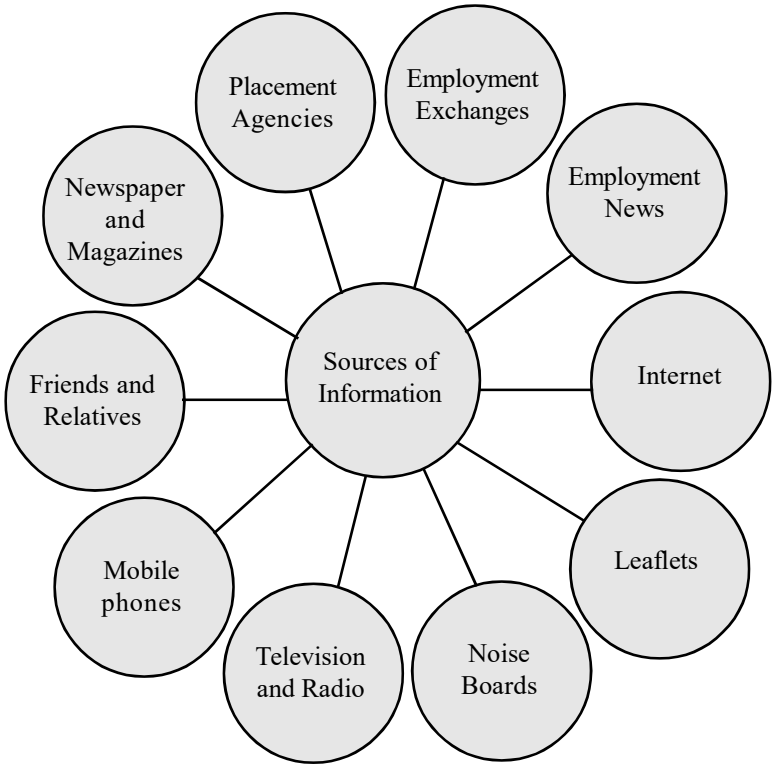


Fig. 21.1 Sources of information

Let us have a brief idea of all these sources.

1. **Employment Exchanges:** In our country employment exchanges have been setup by the government for bringing together job seekers and job-providers. The employment exchange maintains the list of job seekers and registers their names for different categories of jobs according to their qualifications. When the employers approach the employment exchange for recruitment, it identifies the candidates from its list and informs them about these vacancies so that they can approach the concerned employers.

2. **Placement Agencies:** These are privately operated organisations whose mainfunction is to introduce the job seekers to their prospective employers. Their role is similar to the government owned employment exchanges

3. **Newspaper and Magazines:** The use of newspapers and magazines both at regional and national level, are the most commonly used mode of information for the candidates about the job vacancies. The employers usually advertise the job vacancies and invite the prospective candidates to offer their candidature by applying for the advertised job position.

4. **Employment News:** The Employment News/Rozgar Samachar is published by Ministry of Information and Broadcasting, Government of India every week. It contains advertisements of vacant position of jobs in different government organisations. This is simultaneously published in English, Hindi and Urdu languages for wider circulation.

5. **Internet:** Internet is the most convenient source of getting information about the availability of vacancies. A number of organisations, now-a-days invite applications through their websites to fill up the vacancies in their offices. By using internet one can search for various job vacancies as per his/her qualifications and experience.

6. **Leaflets:** In cities and towns advertisement for recruitment are sometimes given in leaflets which are distributed by the newspaper vendors along with the daily newspaper. This is particularly suitable where the employer wants to engage the local people for specific jobs only.

7. **Notice Boards of Offices and Factories:** Information about various job vacancies are also displayed on the notice boards of government and private offices and often notices displayed at the factory gates.

8. **Television and Radio:** Sometimes information about job vacancies are also telecasted through television such as for recruitment to defence forces. It may appear in special programmes or in the form of written message being scrolled during news and other programmes. The cable television operators also give advertisement in the local areas. The advertisements for job vacancies are also broadcasted through radio, which is regaining its popularity now-a-days.

9. **Mobile Phone:** Information about job vacancies are sometimes received through mobile phone in the form of SMS. On receiving the message one may apply and offer his/her

candidature for the job.Further information can also be obtained by following the instructions given in the SMS.

10. **Friends and Relatives:** Many times we also get information from our friends and relatives about the job vacancies in government, private and business enterprises. The existing staff of the offices may also inform others about the existing vacancies.

17.2 ROLE OF EMPLOYMENT EXCHANGES

The primary objective of Employment Exchanges is settlement of job seekers either through regular jobs or through self-employment. To achieve this objective the employment exchanges in India perform the following functions:

(a) Registration and placement of job seekers so as to ensure a proper balance between demand and supply of labour;

(b) Collection of comprehensive employment market information on a quarterly basis for creation of data base for use in effective management of the demand and supply of labour,

(c) Undertake career counselling and vocational guidance with a view to effectively guide the job seekers.

(d) Conduct area specific specialised study or surveys to have an assessment of skills available and the marketable skills required for encouraging the job seekers for self-employment, particularly, in rural informal sector.

(e) Arrange for disbursement of unemployment allowance to certain specific categories of job seekers through the employment exchanges as decided by some of the State Governments.

There are more than 940 Employment Exchanges run by the State Governments to provide support to the job seekers. These include State Employment Exchange (SEE) District Employment Exchange (DEE), Rural Employment Bureau (REB), University Employment Information and Guidance Bureau (UEI and GB) etc. The Employment exchanges are controlled by Directorate General of Employment and Training (DGE &T).

17.2.1 PROCEDURE OF REGISTRATION

The procedure of getting a person's name registered with the employment exchange is as given below: -

1. A candidate can visit any Employment Exchange during specified hours on any working day. He can get from the employment exchange a blank form/ card for registration to be filled up. This card includes entries for the name, father's name, residential address, qualifications, whether general or SC/ST category, N.C.O. Code No., job desired, location where the candidate wishes to serve, salary expected, work experience and other related information.

2. Certain documents have to be enclosed with the card, such as proof of age, photocopies of educational qualifications, experience, as well as a photocopy of Proof of residence like driving license, Voter's identity Card, PAN card number, passport or ration card. The candidates are required to bring all certificates/ documents in original and a set of photocopies of all the above documents. The photocopies are retained by the Employment Exchange.

3. Having filled the required information on the card, and with the enclosures (documents) ready, you are to see the Employment Officer with your original certificates and photocopies. He will verify and attest the photocopies, and your signature on the Card and return the original certificates.

4. The card as attested above will be kept in the Employment Exchange for record and making future calls for employment, and a registration card, bearing code no. of the job (NCO), date of registration, and your specimen signature will be handed over to you. This registration card is to be renewed after every three years. In case of any correspondence with the employment exchange you need to mention your registration number.

It may be mentioned here that in the present employment scenario, the role of Employment Exchanges is not significant. A large number of recruiting agencies like Staff Selection Commission, Railway Recruitment Boards and Banking Service Recruitment Boards etc. have come up and they have restricted the area of operations of the Employment Exchanges. In fact today almost all the major establishments both in Government and outside have their own recruitment agencies. The judgments of the Supreme Court have made it obligatory on the part of the employers to advertise the vacancies in other media and consider applications submitted not only by the employment exchanges but also those responding to the open advertisements for selection of candidates. Therefore, Employment Exchanges are left with limited categories that too for the lower level job appointments.

17.2.2 KINDS OF JOBS AVAILABLE THROUGH EMPLOYMENT EXCHANGES

The Employment Exchanges sponsor the names of registered applicants for different types of jobs. The list of some of such jobs/posts for which the Employment Exchanges generally sponsors the names is as follows:

Aya	Meter Reader
Barber	Motor Mechanic
Booking Clerk	Nurses
Caretaker	Office Assistant
Carpenter	Operation Theatre Technician
Data Entry operator	Peon
Doctor	Pharmacist

Electrician	Physiotherapist
Instructor (Steno / Steno typist)	Plumber
Journalist	Programmer (Computer Software)
Laboratory Assistant	Receptionist
Laboratory Attendant	Safai Karamchari
Laboratory Technician	Sales Representative
Librarian	Sanitary Inspector
Library Attendant/Assistant	Security Guards
Lift operator	Stenographer
Mali	Teacher (Aided and Primary schools)
Messenger	Telephone Operator
Typist	Travel Agent
X-Ray Technician	Translator

17.3 ROLE OF PLACEMENT AGENCIES

The Placement Agencies could be Private Employment Agencies or Management Consultants. Private Employment Agencies bring together the employers and suitable candidates available for a job. Private agencies advertise the vacancies in the newspapers, periodicals and on the internet. They prepare the data bank of all the prospective employers and job seekers. This data bank helps them to find out the suitable employer for a job seeker and vice versa. They keep on informing the job seekers periodically about the employers and the availability of jobs according to their qualifications, skills and experience. Some placement agencies also help the candidates in preparing their bio-data and other supporting documents.

The placement agencies also screen the applicants against the requirements specified by the employer. They supply a list of shortlisted candidates, and the organisation only conducts the final round of interview. These agencies function primarily in the Metropolitan cities and they charge a fee from the employer as well as the employee for their services. Fake placement agencies are also found in different parts of the country. These fake agencies collect money from the jobseekers and arrange fake interviews. Job seekers, therefore must, be careful in utilizing their services.

Management Consultants specialize in the placement of executives at middle and top level of management. These are basically executive searching agencies. These agencies work at a nationwide level and they charge a substantial amount of fee from employer as well as the employee. They work for large, medium, small-scale companies They have a huge database of job vacancies Some of the well

known Management Consultants in India are ABC Consultants, Ferguson Associates, The Search House and Analytic Consultancy Bureau.

The placement agencies basically help in informing about the availability of jobs in private sectors. Most of the small and medium size business enterprises rely upon the placement agencies for all types of manpower requirements. The big enterprises often advertise the vacancies directly through newspapers and internet. The job seekers can register their name with placement agencies for the post of office assistant, typist, salesperson, marketing executives, accounts assistant, computer operators etc.

17.4 ROLE OF ADVERTISING MEDIA

You have learnt about the role of Employment Exchanges and Placement Agencies in helping the job seekers to get the job of their liking. The advertising media also play an important role in informing the job seekers about the job vacancies and procedure to be followed in applying for these jobs. Advertisements for the job vacancies can be given in print media and electronic media. Print media includes daily newspapers, Employment News, journals and magazines etc. Similarly, electronic media mainly includes Internet, Television and Radio.

17.4.1 PRINT MEDIA

Newspapers are the most common print medium for advertisements of job vacancies. All small and big companies advertise their job vacancies in most widely read newspapers both at regional level and national level. The Employment News is a weekly publication that only publishes advertisements for job vacancies. Some of the popular newspapers carry their employment news editions on a weekly basis.The advertisement for job vacancies in print form receives tremendous response from the job seekers because it contains details about the eligibility criteria, proforma of application form, necessary instructions to fill and submit the application form etc.

17.4.2 ELECTRONIC MEDIA

With the advancement of Information and Communication Technology, electronic media has become the most common and convenient source of recruitment. There are so many websites that provide information about employment opportunities. Some of the popular job websites are www.naukri.com, www.monsterindia.com, www.careerindia.com, www. placementindia.com. They provide the facility of searching various jobs as per:

- the category (like computer, academic, engineering, sales and marketing, finance etc.)
- the required post (fitter, electrician, office assistant, teacher etc.)
- the place of job (i.e. the city or state within which the job seeker wants to search for a job)
- the experience (number of years of experience)
- expected compensation (annual package from 2 to 3 lakhs, 3 to 5 lakhs, 5 to 10 lakhs etc.)

The job seekers can find out the information about various types of job on the basis of the above criteria just by visiting the websites of different placement agencies. The job seekers can also post their resume at these placement agencies to find out a suitable job for them. They get information about the availability of jobs as per their qualification and experience through email and accordingly take the action to contact the employers for interview. The employers can also use those resumes and directly contact the job seekers as per their requirement.

17.5 APPLYING FOR A JOB

In the earlier sections of this lesson you have learnt about the various sources from where you could get the information about the availability of job vacancies, qualifications and experience required and also, details about the employer. Now suppose for a particular post you would like to offer your candidature. What would you do? Obviously, you have to prepare an application containing your qualifications, work experience and other details to justify yourself as the most suitable candidate for that post. This brief account of one's professional or work experience and qualifications is termed as the Biodata (Biographic Data) or Resume or Curriculum Vitae (CV).

17.5.1 PREPARATION OF A BIO-DATA

Let us learn how to prepare a Biodata. In most of the cases the employers want to receive the application in their prescribed proforma that makes their job easier in screening the applications. In that case you need not worry about preparing your own biodata in a different style to attract the attention of the employer. But in other cases, mostly for jobs in private sector you should pay special attention to the style, language, presentation as well as contents of your biodata. Your biodata should contain factual details. You must avoid preparing a lengthy biodata. You must briefly describe your qualifications, responsibilities handled, work experience, achievements etc.

Your bio-data should have four basic sections.

1. your name and contact details,
2. your educational qualifications (academics and technical),
3. your work history (responsibilities, experience and achievements etc.)
4. details regarding references.

The list of enclosures may be mentioned at the end of your bio-data.

In brief, your bio data should have the following points: -

1. Full Name (in Block Letters):
2. Father's/Husband's Name:
3. Date of Birth:
4. Residential Address:

5. Details of Educational Qualifications:

6. Details of Technical or Professional Qualifications, if any:

7. Work Experience:

8. Name & Contact No. of References:

9. List of Enclosures:

10. Signature of the Candidate

The above points may be presented in different format and style. Now-a-days the employer wants to scan a bio-data quickly rather than read page after page about your qualifications and achievements. Therefore, be brief and clear with just sufficient details to convey the requisite information. A brief guide to help you to arrange the above-mentioned details in a proper sequence is as follows:

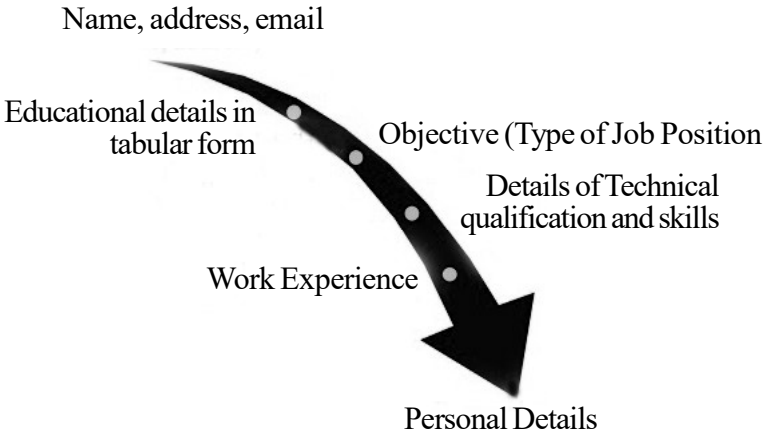


Fig. 21.2 Components of Biodata

Components of a Resume

1. Begin your resume with your name, address, phone number, and email address, generally at the centre of the page.

2. Describe the type of job position you are seeking in a sentence or two under a heading labelled 'Objective'.

3. Now, give your educational details - the name of the school, college, institute, board, percentage of marks secured, year of passing the examinations etc. in a tabular form.

4. Details of any technical education or skills you have acquired may be mentioned. It may include information about any such skills or experience like computer skills, additional training, foreign language or any other professional skill.

5. Work experience with job description and responsibilities handled should be described.

6. Personal details like marital status, date of birth, Father's/Husband's name or family details, hobbies and interests can be given under a separate heading as 'Personal Details'.

17.5.2 COVERING LETTER

When applying for a job, the bio-data should be accompanied with an appropriate covering letter. In this section let us learn what to include and how to write the different sections of a covering letter.

(a) **The Opening:** This is where you tell the employers 'who you are', 'why are you writing' and 'how you came to know about the vacancy'! The 'who are you' part is a brief introduction of yourself. Just mention the basic facts about yourself. In the 'why you are writing' part you mention which position you are applying for. Then be sure to mention how you heard about the organisation or the job. You might write "This is with reference to your advertisement in Hindustan Times dated 29 January 2014 regarding the vacancy of a trainee in your organisation's sales department".

(b) **Suitability of Your Candidature:** The objective of this part of the letter is to mention the reason why the employer should see you as a prospective candidate. It is best to start with a statement that provides an overview of your qualifications and emphasizing that these match with the job position requirements A typical sentence may be "As a trained graduate in management I possess the following skills and accomplishments".

(c) **About the Organisation:** In this section of the letter you may tell something positive about the organisation and mention why you would like to work there. You might mention the reputation of the organisation, past record, sales records, size, corporate culture, management or anything else that is remarkable and distinct about it. Prospective employers like to know that you have chosen them for a specific reason and they are not just one of the hundreds of the companies in which you are applying for a job.

(d) **Request for further action:** This is the closing paragraph of the letter. The closing paragraph is about thanking the employer for spending time to read your letter or for considering you as a candidate for the job. It is an important thing to end the letter in a courteous way by taking the initiative to follow up.

Finally, check your letter for typographic errors, misspellings and grammatical errors. Now, you are ready for the 'complimentary close'. Do not forget to put your signature at the end of your letter.

17.5.3 SOME DO'S AND DON'TS TO BE CONSIDERED WHEN APPLYING FOR A JOB

So you have just seen that applying for a job means preparing your bio data and covering letter as the best marketing documents for yourself. The following list of do's and don'ts will help you in preparing your application in a better way.

(a) Follow all the instructions strictly as given in the advertisement. If it says send three photographs or three copies of resume, do send as directed. The employer may have his own reasons to ask you to do that.

(b) Make sure your application is sent and received on time. Many companies do not even acknowledge late applications as they reflect on the poor time management skills of the applicants.

(c) Do enclose all documents in one application. Make sure all your documents are in order and tied up properly with the covering letter on top.

(d) Don't use the same covering letter every time you apply for a job. Write a fresh covering letter every time you apply by making changes appropriate for the job position you are applying for. Do not customise it.

(e) Don't assume that your application has been received. Confirm from the employer or the placement agency if they have received your application. There is a possibility that applications might get misplaced in post. It is even good to confirm whether the e-mail has been received.

(f) Don't include references in your application. Include them only if asked for by the employer.

(g) Try to gather all the facts before applying for a job and tailor your application accordingly.

(h) If your application is not considered then do find out the reason. Learn from it. Knowing your weaknesses will help you to improve while applying the second time.

17.6 EMPLOYMENT TESTS

The selection test for employment is usually held in the form of a written test, physical fitness and interview. Let us learn about these tests in brief.

17.6.1 WRITTEN TEST

Most of the organisations particularly in government sector conduct written test for the selection of candidates. This test may be conducted to test the subject knowledge or general aptitude of the candidates. Descriptive or multiple-choice questions are framed for the written test. To test the general aptitude, questions are asked on current affairs, general science, reasoning, arithmetic, languages etc. The job seeker must prepare and practice thoroughly for the written test.

17.6.2 PHYSICAL FITNESS TEST

In certain categories of jobs like Defence, Police and Forest Service physical fitness of the candidate is essential. So, they conduct physical fitness test for selection of right candidate. In almost all cases medical test is also conducted before giving offer of appointment. This test is arranged to know whether the candidate is suffering from any serious disease that might affect his/her normal functioning at work.

17.6.3 INTERVIEW

To judge the communication skills, presentation skills, command of the subject, leadership qualities, personality etc. the employers usually arrange for an interview. This may be done in the form of a group discussion and personal interview. For group discussion, small groups are formed to discuss any specific topic. During the discussion the employer judges the communication skills and leadership qualities of

the candidate. The employer can observe the candidate's performance sitting in the discussion room or through a close circuit television. This process can also be carried out in teleconferencing mode in which the employer can observe the process sitting at a distant place, located even abroad.

In personal interview, the prospective employer and employee interact with each other by using different modes. Here the prospective employer tries to evaluate the candidate's personality, communication skill, command of the subject, judgement, honesty, integrity, tolerance, patience, politeness, promptness etc. The personal interview can be held in the form of -

(a) Telephonic Interview

(b) Interview through Teleconference

(c) Chatting through Internet

(d) Face-to face-interaction

Face-to face-interview is the most common form of personal interview in which the candidate is asked to interact with the interview board. The interview board is headed by a chairperson and comprises of senior officers from the same organisation and outside experts. The other forms of personal interview like telephonic interview, interview through teleconferencing and chatting through internet are common in the corporate sector.

17.6.4 PERSONAL INTERVIEW

The main purpose of holding personal interview is to assess the suitability of the candidate for a particular post. So it is very important for you to prepare for the interview physically, mentally and psychologically. In this section, you shall learn about different aspects of personal interview that would help you to face the interview board comfortably and confidently. Let us discuss these points by classifying the entire procedure into three different stages -

(i) Preparing for the interview;

(ii) On the day of the interview; and

(iii) During the Interview.

Let us discuss these in detail.

(i) Preparing for the Interview

At this stage you are advised to do the following:

1. Keep yourself well informed about current affairs, important current national and international problems and issues and topics of general interest through regular reading of newspapers and listening to the radio and watching the discussions on television.

2. Gather information about the organisation, its main activity, background, expansion / takeover plans etc. All this information can be obtained from the Annual Report of the organisation or from its website.

3. Know the job profile of the post applied for.

4. Refresh your area of specialisation. A revision of your own subject of studies is desirable.

5. List out your strengths and weaknesses.

6. Visit the site of interview, if possible. Prior visit will help to ensure punctuality on the day of interview and also will reduce nervousness. Put all your documents and certificates including the call letter for the interview in a folder.

(ii) On the Day of the Interview

1. Have a good sleep in the previous night and wake up early in the morning.

2. Do your daily chores.

3. Ensure that your appearance is neat and tidy. Wear well ironed clothes, wellpolished footwear.

4. Carry your document folder and reach the interview site on time.

5. After reaching the site go to the washroom, comb your hair and watch your appearance.

6. Then wait at the interview place for your turn.

7. During the waiting time you can even ask for the brochure of the company and read it.

(iii) During the Interview

Take care of the following points inside the interview chamber.

1. Entry to the interview room is most important. Knock, greet, and close the door as gently as possible while facing the interview panel.. Walk in confidently. Do not sit until you are asked to. If the interviewer gives a hand, give him a warm, confident and firm handshake. Remember first impression is very important. In your entry you are being observed for your gait, confidence and manners.

2. The body language of the candidate is observed carefully. Sit properly and bend forward slightly to show an attitude of interest and attention. Do not fiddle with anything, like pen, paper, spectacles, other items on table like paperweight etc. Fidgeting, twitching, scratching etc. show lack of confidence and concentration.

3. While answering questions the following points need to be observed:

   - Listen, think and then talk.

- Do not be in a hurry to answer. Take your own time.
- If you have not heard or understood the question, politely ask for a repeat. Do not assume things and make a wrong statement.
- If you do not know the answer, tell frankly that you do not know.
- If you make a mistake, admit it gracefully.
- Be brief and clear in your reply. No one likes a talkative person.
- Do not tell a lie. Be honest in your response.
- Do not get angry and lose your control even if the questions are insulting or irrelevant. Remember it may have been asked to check your patience or attitude.

4. Do not interrupt. Maintain eye contact.
5. Avoid words like 'I mean', 'Okay' etc.
6. Display enthusiasm, courage and energy while answering the questions. This shows that you are genuinely interested in the job.
7. Ask questions if you are told to ask.
8. Be well mannered during the whole interview. Words like 'Thank you' 'I beg your pardon', ' yes please' at appropriate places reflect your manners.
9. Be natural. Don't try to copy anyone.
10. At the end of the interview, thank the interviewer politely with a smile.
11. You're picking up things from the table, getting up and leaving the room is also observed. Do these movements confidently.
12. Walk confidently. Open the door while facing the interviewer and close the door after you leave.
13. Do not forget to wish the receptionist or secretary before you leave the premises.

Analyze the interview to know what went wrong if you fail, accept it and get ready for the next interview.

Some typical questions asked at an interview	What do interviewers look for in a candidate?	Some common reasons for rejection at an Interview
• Why do you consider yourself suitable for this job? • Tell me something about yourself or your family background. • What are your Strengths and weaknesses? • Why do you want to join this company? • Why have you chosen this line/field? • What are your goals in life? • What are your hobbies ? and how do you spend your free time? • What are your salary expectations?	• Personality • Knowledge of the subject/intelligence • Education and experience • Communication Skills • Past achievements • Personal qualities like honesty, integrity, tolerance, patience, politeness, promptness etc.	• Poor Physical Appearance • Lack of courtesy/ manners • Lack of sincerity • Dishonesty • Poor communication skills • Disorganised and vague answers • Telling lies • Non-punctuality • Lack of knowledge/ intelligence • Loud voice • Under/over confident • Poor grooming

TERMINAL EXERCISE

Very Short Answer Questions

1. Enumerate any four sources of information of vacancies for jobs.
2. State the role of management consultants in the process of recruitment.
3. What is meant by the term 'resume'?
4. Name any four personal qualities of a job seeker.
5. What are the qualities an interviewer can judge from 'Group discussion'?

Short Answer Questions

1. Employment Exchanges are not playing a significant role in the process of recruitment. Do you agree with this statement? Give reasons.
2. Explain any two sources that provide information about job vacancies.
3. State the functions performed by placement agencies in the process of recruitment.
4. State any four points one should mention in his/her bio-data.
5. Describe the role of print media in providing information about the vacancies advertised.

Long Answer Questions

1. Briefly describe the procedure for getting your name registered in employment exchanges.
2. Explain the role of employment exchanges in India.
3. Describe the role of electronic media in helping the job seekers to get the jobs of their liking.
4. What are the points one should consider while preparing a covering letter for sending bio-data to a company?
5. Describe in brief the interview form of selection test.

18. SKILL DEVELOPMENT

Skill development is an initiative by the Central Government to accomplish the vision of Skill India.It is aimed at developing the skills of youth who could be employed in industrial organisations.The Government launched Skill India Programme in 19 centres on 15th July 2015.These centres include. Agartala, Ahmedabad, Aizawl, Baddi, Chennai, Daman, Dehradun, Gangtok, Hyderabad, Itanagar, Jaipur, Lakshadweep, Mumbai, Patna, Port Blair, Puducherry, Silvassa, Shillong, Udhampur. Skill India is a focused approach to develop the skills required by the industry. The Central Government has also created a dedicated Ministry of Skill Development and Entrepreneurship to give a fillip to skills.

LEARNING OUTCOMES

- explains the concept of Skill Development;
- identifies the objectives and features of Skill India;
- highlights the need and importance of Skill Development; and
- describes use of the Government initiatives, NSDC and other bodies

18.1 CONCEPT OF SKILL DEVELOPMENT

Skill India or National Skills Development Mission of India is a campaign launched by Prime Minister Narendra Modi on 15th July 2015 which aims to train over 40 crore people in India in different industry-related skills. Because of its importance, 15th July of each year is celebrated as World Youth Skills Day. This policy replaced the National Policy on Skill Development 2009.

The vision of Skill India is to create an empowered workforce by 2022 with the help of various schemes and training courses. It includes various initiatives of the government, like:

- National Skill Development Mission
- National Policy for Skill Development and Entrepreneurship, 2015
- Pradhan Mantri Kaushal VikasYojana (PMKVY)
- Skill Loan scheme
- Rural India Skill

Skill Development is an initiative by the Central Government to accomplish the vision of Skill India. It is aimed at developing the skills of youth who could be employed in industrial organisations. To accomplish this goal, the Central Government has also created a dedicated Ministry of Skill Development and Entrepreneurship to give a fillip to the objectives of Skill India as discussed in the next section of this chapter.

Skill Development is the process of:

- identification of skill gaps, and
- developing the existing skills to enable an individual to achieve his / her goals.

18.2 OBJECTIVES AND FEATURES OF SKILL INDIA

Skill India has defined the following objectives toward which it strives:

- To create opportunities, space and scope for the development of the talents of the Indian youth.
- To develop more of those sectors which have already been put under skill development for the past so many years.
- To identify new sectors for skill development.
- The new programme aims at providing training and skill development to 500 million youth of our country by 2020, covering each and every village.

These objectives are in line with the government's push for adequate availability of skilled manpower for micro enterprises, small scale, medium and large scale industries including Special Economic Zone (SEZ) and industrial parks as a whole. The government also aims to bring about convergence in various employment schemes along with effective training and placement mechanisms.

Skill India is unique in comparison to previous initiatives taken by central and state governments. The features that make it unique are:

- The emphasis is to skill the youth in such a way so that they get employment and also improve entrepreneurship.
- Provide training, support and guidance for all occupations that were of traditional nature like carpenters, cobblers, welders, blacksmiths, masons, nurses, tailors, weavers, etc.
- More emphasis has been given on new areas like real estate, construction, transportation, textile, gem industry, jewellery designing, banking, tourism and various other sectors, where skill development is inadequate or nil.
- The training programmes are on the lines of international level so that the youths of our country can not only meet the domestic demands but also of other countries like the US, Japan, China, Germany, Russia and those in the West Asia.
- Another remarkable feature of the 'Skill India' programme would be to create a hallmark called 'Rural India Skill', so as to standardise and certify the training process.
- Tailor-made, need-based programmes have been initiated for specificage groups which can be like language and communication skills, life and positive thinking skills, personality development skills, management skills,behavioural skills, including job and employability skills.

- The course methodology of 'Skill India' is innovative, which includes games, group discussions, brainstorming sessions, practical experiences, case studies etc.

18.3 NEED AND IMPORTANCE OF SKILL DEVELOPMENT

1. A Massive Young Population

   India is the second most populated country in the world with nearly a fifth of the world's population. According to the 2019 revision of the 'World Population Prospects', population stood at 135 crores. India has more than 50% of its population below the age of 25 and more than 65% below the age of 35. It is expected that, in 2020, the average age of an Indian will be 29 years, compared to 37 for China and 48 for Japan. Such a large young population mandates that the government must work out ways of ensuring that they are gainfully employed to help realise the dream of India becoming a world superpower and a developed country. Skill India is a pivotal initiative in this direction.

2. **Support for Industrial and Agricultural growth**

   Investment in human resource development through skilling provides an adequately skilled population that directly and favorably impacts the industrial and agricultural growth of India.

3. **Promotion of Entrepreneurship & Small & Medium Enterprises**

   Entrepreneurship is the key to India's development as an economic superpower. Skill India is therefore a cornerstone for supporting skilled entrepreneurs who can in turn be job creators in their own right. 4. Bridging the Gap that Education Sector is not able to Fulfill Indian education system lags in certain aspects of preparing students for employment in the industry. Therefore, Skill India was needed to bridge the gap between unskilled and educated manpower and make industry-ready manpower available to all types and scales of industry.

18.4 SKILL DEVELOPMENT INITIATIVES

18.4.1 PRADHAN MANTRI KAUSHAL VIKAS YOJANA - PMKVY

Pradhan Mantri Kaushal VikasYojana (PMKVY) is a unique initiative by the Government of India that aims to train about 24 lakh Indian youth to be industry relevant, skill based and to be ready for the global market. Under this scheme, the trainees will also be given financial support and a certificate on successful completion of training and assessment, which will help them in securing a job for a better future. This scheme mainly focuses on the upbringing of youth and to prepare them to face the challenges of the industrial world.

Keeping in mind the very less emphasis laid on skill development in schools and colleges, the government has decided to set up training centers. Interested candidates need to undergo certain basic steps to take part in the course. Candidates are firstly expected to find a training center, get enrolled, learn the required skill, be a part of an assessment and a certification programme and gain a reward at the end. The PMKVY scheme is being implemented successfully with many skill sectors all over the

country. PMKVY 2.0 is expected to be completed by 2020. This is concurrent with the proposed launch of PMKVY 3.0.

18.4.2 NATIONAL SKILL DEVELOPMENT MISSION

National Skill Development Mission (NSDM) was launched by the Hon'ble Prime Minister on 15th July, 2015 on the occasion of World Youth Skills Day to provide a strong institutional framework to implement and scale up skill development efforts across the country and to train a minimum of 300 million people by the year 2022. Under the Mission, 20 Central Ministries / Departments including Ministry of Skill Development and Entrepreneurship are involved in the implementation of more than 40 schemes/programmes on Skill Development. The implementation of skilling activities under the Mission will be as per the budget provisions of various schemes under their respective heads.

Further, the National Skill Development Fund has been set up by the Government of India with an initial corpus of Rs. 995.10 crore for skill development in the country.

18.4.3 NATIONAL POLICY FOR SKILL DEVELOPMENT AND ENTREPRENEURSHIP, 2015

The core objective of the Policy is to empower the individual, by enabling her/him to realize her/his full potential through a process of life long learning where competencies are accumulated via instruments such as credible certifications, credit accumulation and transfer, etc. As individuals grow, the society and nation also benefit from their enhanced skills. The national policy will:

I. Make quality vocational training aspirational for both youth and employers.

II. Ensure both vertical and horizontal pathways to skilled workforce for further growth by providing seamless integration of skill training with formal education.

III. Focus on an outcome-based approach towards quality skilling that on one hand results in increased employability and better livelihoods for individuals, and, on the other hand, translates into improved productivity across primary, secondary and tertiary sectors.

IV. Increase the capacity and quality of training infrastructure and trainers to ensure equitable and easy access to every citizen.

V. Address human resources needs by aligning supply of skilled workers with sectoral requirements of industry and the country's strategic priorities including flagship programmes like "Make in India".

VI. Establish an IT-based information system for aggregating demand and supply of skilled workforce which can help in matching and connecting supply with demand.

VII. Promote national standards in the scaling space through active involvement of employers in setting occupational standards.

VIII. Recognise the value of on-the-job training, by making apprenticeship in actual work an integral part of all skill development efforts.

IX. Ensure that the skilling needs of the socially and geographically disadvantaged and marginalised groups (like SCs, STs, OBCs, minorities, differently-abled persons, etc.) are appropriately taken care of.

X. Promote increased participation of women in the workforce through appropriate skilling and gender mainstreaming of training.

18.4.4 SKILL LOAN SCHEME

A skill loan initiative is launched in which loans from Rs.5000 - 1.5 lakhs will be available to those who seek to attend skill development programmes, over the next five years. The idea is to remove financial hindrances in accessing skill training programs.

18.4.5 NATIONAL RURAL LIVELIHOOD MISSION - AJEEVIKA SKILLS

Aajeevika - National Rural Livelihood Mission (NRLM) is an initiative launched by the Ministry of Rural Development (MoRD), Government of India. The Aajeevika Skill Development Programme (ASDP) operates under NRLM. Its aim is to understand the professional aspirations and interests of youth and to also increase their daily income. This mission provides young people from poor communities an opportunity to upgrade their skills and join the skilled workforce of the country. Some key features of the scheme include, post placement support, food and transport during training and assured placement.

NRLM wishes to bring a change by supporting entrepreneurial skills of the poor by creating appropriate platforms through dedicated and sensitive support structures. NRLM has a demand driven strategy and also encourages states to have their own perspective of implementing this scheme. Through this scheme, the private sector is also being encouraged to set up self-employment generation training institutes.

18.4.6 DEEN DAYAL UPADHYAY GRAM KAUSHAL YOJANA - DDU-GKY

The Deen Dayal Upadhyay Gram Kaushal Yojana (DDU-GKY) is a placement linked skill development programme for the rural youth. To date there have been 66 special projects that were taken up under the DDU-GKY scheme. 15 states have a minimum of five approved projects and many in the pipeline.

DDU-GKY funds a variety of skill training programmes all over the country that include over 250 trades such as Retail, Hospitality, Health, Construction, Automotive, Leather, Electrical, Plumbing, Gems and Jewellery, to name a few. DDU-GKY is being adopted throughout India as the scheme is being implemented on a large scale in almost all the states and union territories.

18.4.7 DEENDAYALANTYODAYAYOJANA - NATIONAL URBAN LIVELIHOODS MISSION - DAY-NULM

The main aim of DAY-NULM mission is to curb poverty of the urban poor households by providing them access to their skill related employment opportunities in an organised manner. As a part of this

scheme, regional workshops have also been conducted to support urban homeless, urban street vendors etc. A major objective of the scheme is to help people earn a sustainable livelihood through skilling and upskilling.

Another objective is to increase the income of urban poor by encouraging them to be a part of courses that can provide salaried employment and or self-employment opportunities which will eventually lead to better living standards. Through this scheme, the government of India also hopes to eradicate the threats that a regular worker faces in the unorganized sectors of work. The belief that poor also have entrepreneurial capability and have an intent desire to come out of poverty is what drives this mission.

18.4.8 MAHATMA GANDHI NATIONAL RURAL EMPLOYMENT GUARANTEE ACT - NREGA

NREGA guarantees the right to work in rural areas by providing wage employment to unskilled manual workers. People are ensured of at least 100 days of employment in every household to a member who is willing to do unskilled work. Employment under NREGA has a legal clause and the employment schemes are directly implemented by the gram panchayats.

Apart from providing economic security and creating rural assets, NREGA also aims at protecting the environment, empowering rural women, reducing rural-urban migration and fostering social equity, among others.

18.4.9 DIRECTOR GENERAL OF TRAINING - MODULAR EMPLOYABLE SKILLS - DGTMES

The Government of India and the Ministry of Labour together has launched 'Modular Employable Skills' (MES) under 'Skill Development Initiative' (SDI). Under this scheme, school dropouts and existing workers, specially, in the unorganized sector are to be trained for employable skills. The scheme has been in operation since 2007 and statistics show that a large number of school dropouts do not have access to skill development for improving their employability through various vocational training and apprenticeship programmes.

The basic objective of the scheme is to provide vocational training to school dropouts, ITI graduates, rural and unemployed youth to improve their employability. Also, priority is given to those above the age of 14 years who have suffered in the form of child labour to enable them to learn employable skills in order to get gainful employment.

18.5 ROLE OF NSDC AND OTHER BODIES

18.5.1 NATIONAL SKILL DEVELOPMENT CORPORATION

The National Skill Development Corporation India (NSDC) was set up as a Public- Private Partnership (PPP) Company with the primary mandate of developing and enabling the skills landscape in India. NSDC's underlying philosophy is based on the following pillars:

1. **Create:** Proactively catalyse creation of large, quality vocational training institutions.

2. **Fund:** Reduce risk by providing long-term capital, including grants and equity.

3. **Enable:** The creation and sustainability of support systems required for skill development. This includes the Industry-led Sector Skill Councils.

The main objectives of the NSDC are to:

- Upgrade skills to international standards through significant industry involvement and develop necessary frameworks for standards, curriculum and quality assurance.
- Enhance, support and coordinate private sector initiatives for skill development through appropriate PPP models and to strive for significant operational and financial involvement from the private sector.
- Play the role of a "market-maker" by bringing financing, particularly in sectors where market mechanisms are ineffective or missing.
- Prioritize initiatives that can have a multiplier or catalytic effect as opposed to one-off impact.

Partnerships: NSDC operates through partnerships with multiple stakeholders in catalysing and evolving the skilling ecosystem.

- **Partnerships with Private Sector-** Areas of partnerships include awareness building, capacity creation, loan financing, creation and operations of Sector Skill Councils, assessment leading to certification, employment generation, Corporate Social Responsibility, World Skills competitions and participation in Special Initiatives like Udaan focused on J&K.
- **International Engagements-** Investments, technical assistance, transnational standards, overseas jobs and other areas.
- **Partnerships with Central Ministries -** Participation in flagship programmes like Make in India, Swachh Bharat, Pradhan Mantri Jan DhanYojana, Smart City, Digital India, Namami Ganga, etc.
- **Partnerships with State Governments -** Development of programmes and schemes, alignment to NSQF and capacity building, operationalization of program, capacity building efforts, among others.
- **Partnerships with University & Schools -** Vocationalisation of education through specific training programmes, evolution of credit framework, entrepreneur development, etc.
- **Partnerships with Non-profit Organizations -** Capacity building of marginalized and special groups, development of livelihood, self-employment and entrepreneurship programmes.

- **Partnerships for Innovation -** Support early-stage social entrepreneurs working on innovative business models to address gaps in the skilling ecosystem, including programs for persons with disability.

Since its inception, NSDC has several achievements to its credit. These are:

- Over 52 lakh students trained
- 235 private sector partnerships (each to train at least 50,000 persons over a 10-year period) for training and capacity building.
- 38 Sector Skill Councils (SSC) approved in services, manufacturing, agriculture & allied services, and informal sectors. Sectors include 19 of 20 high priority sectors identified by the Government and 25 of the sectors under Make in India initiative. (refer to the Table 22.1 below)
- 1386 Qualification Packs with 6,744 unique National Occupational Standards (NOS) which have been validated by over 1000 companies.
- Vocational training introduced in 10 States, covering 2400+ schools, 2 Boards, benefitting over 2.5 lakh students. Curriculum based on NOS and SSC certification. NSDC is working with 21 universities, Community Colleges under UGC/AICTE for alignment of education and training to National Skills Qualification Framework (NSQF).
- Designated implementation agency for the largest voucher-based skill development program, PMKVY.
- Skill Development Management System (SDMS) with 1400 training partners, 28,179 training centres, 16,479 trainers, 20 Job portals, 77 assessment agencies and 4983 empanelled assessors.

18.5.2 NATIONAL SKILL DEVELOPMENT AGENCY

The National Skill Development Agency (NSDA), an autonomous body, (registered as a Society under the Societies Registration Act 1860) was created with the mandate to coordinate and harmonise the skill development activities in the country, is part of the Ministry of Skill Development & Entrepreneurship (MSDE).

Functions of NSDA are:

- Take all possible steps to meet skilling targets as envisaged in the 12th Five Year Plan and beyond.
- Coordinate and harmonize the approach to skill development among various Central Ministries/ Department, State Governments, the NSDC and the Private sector.
- Anchor and operationalize the NSQF to ensure that quality and standards meet sector specific requirements
- Be the nodal agency for State Skill Development Missions

- Raise extra-budgetary resources for skill development from various sources such as international agencies, including multilateral agencies, and the private sector.
- Evaluate existing skill development schemes with a view to assessing their efficacy and suggest corrective action to make them more effective.
- Create and maintain a national database related to skill development including development of a dynamic Labour Market Information System (LMIS).
- Take affirmative action for advocacy.
- Ensure that the skilling needs of the disadvantaged and the marginalized groups like SCs, STs, OBCs, minorities, women and differently abled persons are taken care of.
- Discharge any other function as may be assigned to it by the Government of India.

Activities undertaken by the NSDA

Besides anchoring and implementation, the National Skills Qualifications Framework (NSQF), some of the other actions taken by the NSDA are as under:

1. Rationalization of the Skill Development Schemes of the Government of India

NSDA has worked with the various ministries and stakeholders to achieve convergence of norms across the various central schemes for skill development, while at the same time recognizing the special needs of the North-Eastern States, the hill States, and other geographies that pose challenging situations for skill development.

2. Creation of an integrated Labour Market Information System (LMIS)

A national database on all major aspects of skill development is being created in partnership with all other Ministries of the Government of India and the State Governments. This would be a one-shop stop where all the relevant information is freely available to citizens. The LMIS would bring in operational efficiencies, would be transparent and available to all, and would help reduce considerably the situation of one individual being benefited under different schemes.

3. Engagement with States

The NSDA is now actively engaged with the various State governments to plan out their skill development action plan, help them develop their skill development policies, and set up suitable administrative mechanisms. Through Technical Assistance programmes with the Asian Development bank (ADB), European Union (EU) and DFID (Department for International Development of the Government of UK), NSDA is helping the State Skill Development Missions of 11 states build their respective capacities.

4. Skills Innovation Initiative

A committee has been set up under the Skills Innovation Initiative housed under the NSDA. The NSDA invites innovative ideas, concepts and practices on skill development. The Committee reviews all proposals of innovations to facilitate their application on a wider scale.

18.5.3 SECTOR SKILL COUNCILS

Since its inception, one of the major pillars of NSDC's strength are Sector Skill Councils (SSCs), which play a vital role in bridging the gap between what the industry demands and what the skilling requirements should be. Till date, NSDC has approved 38 Skill Councils across different sectors.

The National Occupational Standard is one of the most significant contributions of NSDC to India's skilling ecosystem-something that was made possible by the SSCs, which are national partnership organisations that bring together all the stakeholders -- industry, labour and academia.

Each SSC operates as an autonomous body and could be registered as a Section 8 Company, or a Society. NSDC is mandated to initiate and incubate SSCs with initial seed funding to facilitate their growth and enable them to achieve self-sustainability in a time bound manner.

The list of SSCs and their founding years is given below:

Role of each SSC

The SSCs have been mandated with the following functions:

- Identification of skill development needs including preparing a catalogue of types of skills, range and depth of skills to facilitate individuals to choose from them.
- Development of a sector skill development plan and maintaining skill inventory.
- Determining skills/competency standards and qualifications and getting them notified as per National Skills Qualification Framework (NSQF).

	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Priority Sectors	- Auto - Retail - IT/ITeS	- Media & Entertainment - Gems & Jewelry - Leather - Electronics - BFSI	- Logistics - Construction - Food Processing	- Life Sciences - Hospitality - Textiles & Handlooms - Apparels - Handicrafts - Power - Iron & Steel	- Hydrocarbons - Chemical & Petrochemicals - Furniture & Furnishings - PwD - Green Jobs	- Management - Strategic Manufacturing
Large Workforce		- Rubber - Capital Goods - Agriculture	- Telecom Aviation - Mining	- Aerospace & - Paints & Coatings - Earthmoving & Infra Building	- Sports	- Instrumentation
Informal Sectors			- Plumbing	- Beauty & Wellness	- Domestic Workers	

Table 18.1 - Sector Skill Councils and their founding year

- Standardization of affiliation, accreditation, examination and certification process in accordance with NSQF as determined by the National Skills Qualifications Committee (NSQC).
- May also conduct skill-based assessment and certification for Qualifications Pack /National Occupational standards (QP /NOS) aligned training programmes.
- Participation in the setting up of affiliation, accreditation, examination and certification norms for their respective sectors.
- Plan and facilitate the execution of Training of Trainers along with NSDC and states.
- Promotion of academies of excellence.
- Paying particular attention to the skilling needs of ST/SC, differently-abled and minority groups.
- Ensuring that the persons trained and skilled in accordance with the norms laid down are assured of employment at decent wages.
- Job Placements
- The most critical outcome of skill training is employment, whether self or wage employment.

To facilitate employment, SSCs have been encouraged to develop their own placement portal and mobile apps.

18.5.4 MINISTRY OF SKILL DEVELOPMENT AND ENTREPRENEURSHIP - MSDE

The Ministry of Skill Development and Entrepreneurship (MSDE) is responsible for the co-ordination of overall skill development efforts across the country, building the vocational and technical training

framework, skill up-gradation, building of new skills, and innovative thinking not only for existing jobs but also jobs that are to be created.

The ministry has aided and supported several other missions that also focus on skill development like the -

1. National Skill Development Agency (NSDA),
2. National Skill Development Corporation (NSDC),
3. National Skill Development Fund (NSDF) and
4. 38 Sector Skill Councils (SSCs) as well as
5. 187 training partners registered with NSDC.

The Ministry also wishes to work with the existing chain of skill development training centers, universities and other institutes in the field.

18.5.5 MINISTRY OF LABOUR AND EMPLOYMENT - MOLE

The Ministry of Labour and Employment (MoLE) is one of the oldest and important Ministries of the Government of India.

1. The main responsibility of this Ministry is to protect the interests of workers in general and also the rural and urban poor and deprived section of the society.
2. The Government's attention is also on the promotion of welfare and providing social security to the labor forces both in organised and unorganised sectors.
3. The ministry majorly focuses on women and child welfare and has also started schemes to support various initiatives.
4. The National Career Services is another scheme under the ministry of Labor and Employment which deals with providing job matching services to youth in an easy manner. This project also readily provides information on education, career opportunities, jobs etc.

18.5.6 ROLE OF INDUSTRY IN SKILL DEVELOPMENT

The skill development in India is an imperative as the government cannot accomplish this task alone. The industry is gradually witnessing increased participation from corporate and PSUs who are coming forward and investing in youth by supporting skill development through their CSR initiatives. They are getting involved in a range of activities such as financing, providing infrastructure, recognition of prior learning, adoption of national qualification framework and occupational standards, etc. Organisations like Power Grid, Coal India, NTPC, Ambuja Cements, Essar and Coca Cola are some of the leading examples.

IMPORTANT ABBREVIATIONS:

S.No	Abbreviation	Expanded Form
1	ASDP	Aajeevika Skill Development Programme
2	PMKVY	Pradhan Mantri Kaushal Vikas Yojana
3	DAY-NULM	Deendayal Antyodaya Yojana - National Urban Livelihoods Mission
4	DDU-GKY	Deen Dayal Upadhyay Gram Kaushal Yojana
5	MES	Modular Employable Skills
6	NRLM	National Rural Livelihood Mission
7	NREGA	National Rural Employment Guarantee Act
8	NSDM	National Skill Development Mission
9	NSDF	National Skill Development Fund
10	SEZ	Special Economic Zones
11	SDI	Skill Development Initiative
12	NSDA	National Skill Development Agency
13	MoRD	Ministry of Rural Development
14	DGT-MES	Director General of Training - Modular Employable Skills
15	ITI	Industrial Training Institute
16	NSDC	National Skill Development Corporation
17	PPP	Public-Private Partnership
18	SSC	Sector Skill Councils
19	NOS	National Occupational standards
20	SDMS	Skill Development Management System
21	MSDE	Ministry of Skill Development and Entrepreneurship
22	LMIS	Labour Market Information System
23	ADB	Asian Development Bank
24	DFID	Department for International Development
25	EU	European Union
26	NSQC	National Skills Qualification Committee
27	QP/NOS	Qualifications Pack /National Occupational standards
28	MoLE	Ministry of Labour and Employment
29	CSR	Corporate Social Responsibility
30	NSQF	National Skills Qualifications Framework

TERMINAL EXERCISE

Very Short Answer Questions

1. Briefly complete the following sentence:

   Skill Development is the process of _____.

2. Explain briefly any two features that make Skill India unique in comparison to any previous initiatives taken by the central and state governments.

3. Why is a massive young population in India a big reason for the government's push towards Skill India?

4. Is our existing education system adequate to address the skill needs of the country? Discuss briefly.

5. Is Mahatma Gandhi NREGA scheme enough to fulfil the aspirations of rural development in India? What role are DDU-GKY and DAY-NULM expected to play in rural development?

6. What are the key areas of partnerships that NSDC enters into with the private sector?

7. What is the importance of creating the SSCs as autonomous bodies?

8. Briefly discuss the implementation of the National Career Services scheme under the Ministry of Labour and Employment (MoLE).

Short Answer- Questions

1. Write short s on–

   (a) National Skill Development Corporation

   (b) National Skill Development Agency

2. Write brief s on the following Skill Development Initiatives–

   (a) National Skill Development Mission

   (b) National Policy for Skill Development and Entrepreneurship, 2015

   (c) Pradhan Mantri Kaushal VikasYojana (PMKVY)

   (d) Skill Loan scheme

   (e) Rural India Skill

3. Write briefly the key objectives of Skill India

4. Explain briefly the importance of the Aajeevika Skill Development Programme (ASDP) that operates under NRLM.

5. Which two ministries play a key role in skill development in India. Write brief notes on each.

Long Answer- Questions

1. Explain the objectives of the Skill Development Initiative of the Central Government. What measures have been initiated for the development and upgradation of the skills among the youth ?

2. NSDC operates through partnerships with multiple stakeholders in evolving the skilling ecosystem. List all these partners and write briefly about the role of each of them.

3. Explain the reasons why the government considered Skill Development a very important pillar in the development of India.

4. How does the National Policy for Skill Development and Entrepreneurship, 2015 propose to support the government's agenda of all-round development of India?

5. Rural development 'especially through skills ' is a key government objective. List the key schemes that the government is running to pursue rural development through skill enhancement.

19. MODERN MODES OF BUSINESS

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

LEARNING OUTCOMES

- explains why e-banking/online business is important for business;
- explores the possibility of using online transactions for business; and
- takes- precautionary measures for safe online transactions.

19.1 E-BUSINESS AND E-COMMERCE

Gone are the days when we have to stand in queues to get our ticket booked in railways or airlines or buy our grocery or clothes from local markets. Now everything is just a click away. Now, the virtual market has gained momentum.. Big bazaar is replaced by bigbasket.com and readymade garment shop is replaced by Myntra.com. As stated earlier, to buy goods and services we usually go to a nearby market personally where buyers and sellers get together for transactions. The buyers check the quality and negotiate the price. The sellers, on the other hand, try to persuade the prospective buyers and finalise the transaction. Sometimes, we contact the sellers over telephone or through correspondence to buy the specific goods. These are the common modes of business transactions. However, of late, the virtual market mode is gaining momentum. Through this mode, people get their desired goods and services sitting at their own place without actually visiting the market place. This has been made possible through introduction of information technology. The activities of production, marketing, selling, banking, insurance etc. are all carried out at a faster speed through the use of computers and Internet. When all these activities are carried on electronically, it is commonly referred to as 'Electronic Business' or 'e-Business'. Since Internet plays an important role in all e-Business activities, let us first acquaint ourselves with Internet before we learn as to how it is helpful in carrying out business transactions.

The Internet, sometimes called simply the 'net', is a worldwide system of computers network through which the users at any computer can access the information from other computers. By internet we can connect any computer to any other computer anywhere in the world via dedicated routers and servers. When two computers are connected over the internet, they can send and receive any kind of information such as text, graphics, voice, videos etc. It provides information regarding science and technology, history, politics, sports, business, current events, music, entertainment, news and many more topics. It helps the users in the following ways:

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

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

(c) Exchange messages using e-mail.

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

(e) Transfer files, pictures, animations etc.

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

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

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

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

19.2 ELECTRONIC COMMERCE

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

19.3 HISTORY OF E-COMMERCE

The beginning of e-Commerce can be traced to the 1960, when businesses started using Electronic Data Interchange (EDI) to share business documents with other companies. In 1979, American National Standard Institute developed ASC X 12 as a universal standard for businesses to share documents

through electronic networks. The use grew in 1980s, and the rise of eBay and Amazon in 1990s revolutionized the e-Commerce industry.

E-Commerce takes place between companies i.e., business to business (B2B), between companies and their customers (B2C), customer to customer (C2C) and consumer to business (C2B).

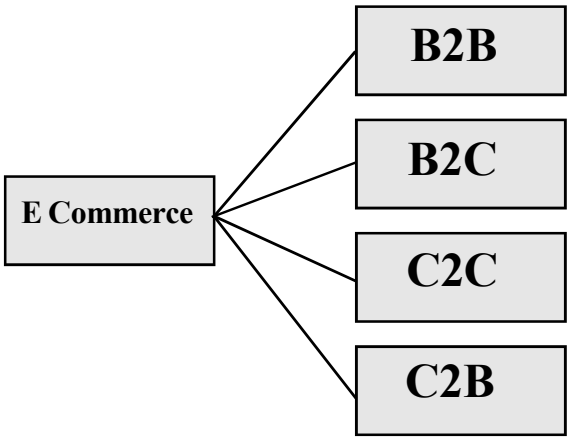


Fig. 19.1 E-Commerce

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

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

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

4. **C2B:** It is a type of e-Commerce in which consumer make their products and services available online for companies to bid and buy. This is an opposite of traditional commerce model of B2C.

19.4 INTRA- B COMMERCE

Normally, one may use the terms 'e-Commerce' and 'e-Business' interchangeably. But, in practice, the term e-Business is used in a broader sense. The e-Business covers not only the interaction with its customers and suppliers but also interactions and dealings among various departments and persons within the firm. Thus, e-Business is a wider term which includes e-commerce and other electronically conducted business functions like production, accounting, finance, personnel, administration etc. In other words, e- Business includes not only B2B, B2C, and C2C but also Intra-B Commerce i.e., interaction and dealings among various departments and persons within the firm. For example, the marketing department may interact regularly with the production department and get the products

made as per the requirements of the customers. Similarly, regular interaction among other departments helps in attaining efficient inventory handling, better cash management, proper utilisation of manufacturing capacity, timely and sufficient provision of customer services, and so on. Thus, e-Business implies use of Internet technologies to perform the key business processes.

Fig. 19.2 E-Business

19.5 BENEFITS OF E-COMMERCE/E-BUSINESS

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

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

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

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

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

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

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

(g) Personalization and Product Recommendation: E-Commerce site can track visitors, browse search and purchase history. They also add other customer's recommendations and reviews which helps us to make a wise decision while buying online.

19.6 LIMITATIONS OF E-COMMERCE/E-BUSINESS

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

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

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

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

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

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

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

The risks relate to:

1. the transaction (default in order taking, default in delivery, default in payment);
2. data storage and transmission; and
3. privacy.

(g) Moreover the privacy of personal details and security of financial transactions are a concern for many users. It may be d that most of the above limitations are applicable to B2C commerce. As for the business buying i.e., B2B e-Commerce, these limitations have little relevance as both the parties are sufficiently knowledgeable, resourceful and well informed, and transact regularly with each other. No supplier therefore, can afford mishandling of any transaction with its business customers. However, there are some challenges, which will have to be overcome. These are:

A. lack of adequate Internet infrastructure;

B. delivery and payment related issues; and

C. absence of cyber laws.

19.7 STAGES IN ONLINE TRANSACTIONS

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

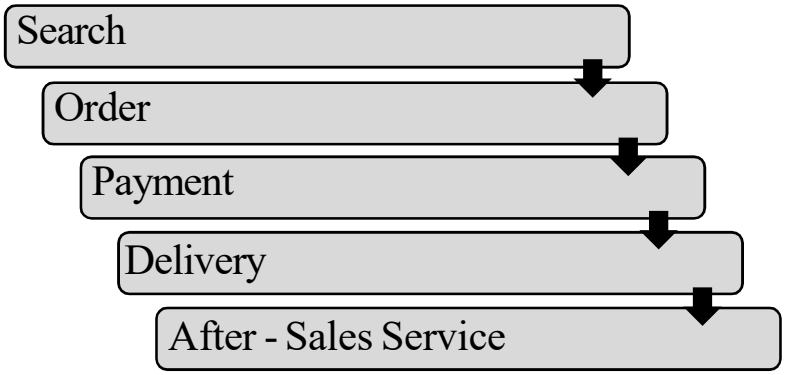


Fig. 19.3 Stages in online transactions

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

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

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

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

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

19.8 PRECAUTIONS FOR SECURITY

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

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

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

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

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

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

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

19.9 APPLICATIONS OF E-COMMERCE

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

19.10.1 E-BANKING

Internet Banking ATM Credit/Debit Card

Fig. 19.4 e-Banking

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

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

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

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

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

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

(e) **Credit Card:** Some banks issue credit cards to individuals who may or may not have an account with them. The cards are issued to individuals after verifying their creditworthiness. The individual can use those cards at various outlets to make payments. The issuing bank fixes a credit limit up to which the cardholder can purchase goods and services. The bank issues a statement of transactions periodically and the individuals have to pay back the amount to the bank by a due date. Thus, the customers get a credit period ranging from 10 to 55 days which varies from bank to bank and the nature of transactions made. No interest is charged if the

payment is made within the due date. If the customers fails to pay back by due date, the bank charges interest at a high rate on the amount due. Most banks give bonus points for transactions and insurance coverage for the products purchased through credit card as well as to the cardholders. The cardholder can also use his/her card to withdraw cash from ATMs.

(f) Education: In educational training also e-Commerce has a major role in interactive education video conference, online classes and in connecting different educational training centers. Now, we also have many online courses and classes. For example, in India we can be part of e-classes conducted by Harward School of Business.

19.10.2 E-TICKETING

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

Fig. 19.5 E - Ticketing

19.10.3 E-ADVERTISING

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

19.10.4 E-TRADING AT STOCK EXCHANGES

Online trading started with the establishment of Over The Counter Exchange of India (OTCEI). Now the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) have also completely switched over to on-line trading to which most stock-brokers have access through internet. It is also taking off among small investors and traders in stocks and shares. Internet makes available to them up-to-theminute information which, until recently, had only been available to financial institutions. The use of on-line brokerage services automates the process of buying and selling. This allows reduction in brokerage charges, makes trading transparent as they can access the

Fig. 19.6 e - Trading

information on market prices online, and the investor is able to deal at a price viewed immediately. The transfer of ownership of stocks and shares can also be recorded electronically in investor's account thereby avoiding the need for physical delivery. This has also made it possible to have rolling settlement and reduce the settlement period to just 2 days.

19.10.5 COMPUTERISATION OF MAIL TRANSMISSION AND PROCESSING

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

19.10.6 E-POST

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

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

19.10.7 RESOURCES REQUIRED FOR SUCCESSFUL E-BUSINESS IMPLEMENTATION

Following resources are required for successful e-business implementation:

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

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

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

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

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

19.10.8 PAYMENT MECHANISM OF ONLINE TRANSACTIONS

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

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

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

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

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

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

   c) **Net-banking transfer:** The buyer may transfer the amount for the agreed price of the transaction to the account of the online vendor.

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

and debit the buyer's account. The debit card allows purchases up to the specified amount that is lying in his account. (available balance)

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

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

19.10.9 SECURITY AND SAFETY OF E-TRANSACTION: E-BUSINESS RISKS

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

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

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

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

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

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

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

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

iii. Customers must shop from well established shopping sites.

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

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

19.11 OUTSOURCING OF SERVICES

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

Need for BPO

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

19.11.1 FEATURES OF OUTSOURCING OF SERVICES

The basic features of outsourcing of services are:

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

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

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

  (i) outsourcing to a third party, and

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

19.11.2 MERITS OF OUTSOURCING OF SERVICES

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

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

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

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

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

19.11.3 LIMITATIONS OF OUTSOURCING OF SERVICES

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

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

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

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

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

19.11.4 KNOWLEDGE PROCESS OUTSOURCING (KPO)

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

Distinction between BPO and KPO

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

TERMINAL EXERCISE

Very Short Answer Questions

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

Short Answer Questions

1. State any four uses of Internet in our daily life.
2. Distinguish between 'e-Business' and 'e-Commerce'.
3. Mention any four limitations of 'e-Commerce'.
4. Distinguish between 'Debit Card' and 'Credit Card'.
5. Explain the usefulness of 'e-Post' facility for the general public.
6. State any two requirements for successful implementation of e-business.
7. What is meant by Knowledge Process Outsourcing?

Long Answer Questions

1. Explain the merits of 'e-Commerce'.
2. Describe the transaction process of 'e-Commerce'.
3. Explain any four new trends of banking services under the e-Banking mode.
4. What is meant by outsourcing of services? Explain its features.
5. State the meaning of 'e-Banking'. Explain any two modes of e-Banking.
6. Distinguish between BPO and KPO.
7. How can security of e-business transactions be ensured?
8. Explain the steps involved in the payment mechanism of online transactions?
9. You are interested in giving a new mobile phone to your mother as a gift on mother's day. One of your friends told you that you can get it quite cheaper through online shopping, for which you have no experience. But you decide to try at least once. Explain the steps you will follow to get the mobile phone for your mother through online shopping.
10. Your father is a businessman having a business of digital watches. He heard a lot about e-business from his friends, newspapers and magazines. Now he is equally interested in entering in the field of e-business as he wants to enter into new markets which were far from his reach. As you are a student of senior secondary, he discussed the matter with you. Explain to him the various resources required for successful implementation of e-business.

20. CONSUMER PROTECTION

A consumer is said to be a king in a free market economy .The earlier approach of caveat emptor ,which means "Let the buyer beware", has now been changed to caveat venditor which means "Let the seller beware".You may have often heard a lot of instances of the consumer being exploited by the sellers and facing problems during the purchase,use and consumption of goods and services due to unfair trade practices such as adulteration, false and misleading advertisement, hoarding , black marketing etc . All this calls for appropriate legal protection to be provided to the consumer.

This is why the Consumer Protection Act was first introduced in 1986, which has now been repealed and the new Consumer Protection Act was enforced on 20th July,2020 replacing the previous act.

LEARNING OUTCOMES

- develop an understanding of a consumer and importance of consumer protection;
- identifies the importance of explaining the rights and responsibilities of consumers; and
- explains the measures adopted to protect a consumer.

20.1 MEANING OF CONSUMER

"A Consumer" means any person who-

(i) buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment, when such use is made with the approval of such person, but does not include a person who obtains such goods for resale or for any commercial purpose; or

(ii) hires or avails of any service for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any beneficiary of such service other than the person who hires or avails of the services for consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment, when such services are availed of with the approval of the first mentioned person, but does not include a person who avails of such service for any commercial purpose.

20.2 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 with 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.

(k) E-commerce will now be governed by all the laws that apply to direct selling. All the e-commerce platforms will have to disclose sellers' details, such as their address, website, email, etc and other conditions related to refund, exchange, terms of contract and warranty on their website to increase transparency.

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:

- Coca Cola was found guilty of supplying drinks unfit for human consumption,which was upheld by the State Consumer Commission and had to pay Rs. 1 lakh for damages to the consumer.
- The after sales service provider of the television set charged Rs 500 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.

20.3 IMPORTANCE OF CONSUMER PROTECTION

Consumer Protection has a vast agenda. It includes educating consumers about their rights and responsibilities and also helps in getting their grievances redressed. Consumer Protection is imperative to both the consumers and the business.

The importance of consumer protection from the consumers' point of view can be understood from the following points:

(i) Consumer Ignorance

In the light of widespread ignorance of consumers, it is necessary to educate consumers about the rights and reliefs available to them so as to prevent consumer exploitation.

(ii) Unorganised Consumers

Consumers need to be organised in the form of consumer organisations which would look after their interests. Though, in India, consumer organisations have been set up , adequate protection is required to be given to consumers till these organisations become powerful enough to protect and promote the interests of consumers.

(iii) Widespread Exploitation of Consumers

Consumers need protection against unscrupulous, exploitative and unfair trade practices like defective and unsafe products, adulteration, false and misleading advertising, hoarding, black-marketing etc.

From the point of view of Business

A business must also lay emphasis on protecting the consumers and adequately satisfying them. This is important because of the following reasons:

(i) Long-term Interest of Business

Enlightened businesses realise that it is in their long-term interest to satisfy their customers. Satisfied customers not only lead to repeat sales but also help to gain prospective customers.

(ii) Business uses Society's Resources

Business organisations use resources which belong to the society and thus, have a responsibility to supply such products and render such services which are in public interest .

(iii) Social Responsibility

A business has social responsibility towards various interest groups. Business organisations make money by selling goods and providing services to consumers thus, their interest has to be well taken care of.

(iv) Moral Justification

It is the moral duty of any business to take care of consumer's interest and avoid any form of their exploitation.

(v) Government Intervention

A business engaging in any form of exploitative trade practices would invite government intervention or action. This can impair and tarnish the image of the company.

20.4 RIGHTS OF THE CONSUMERS

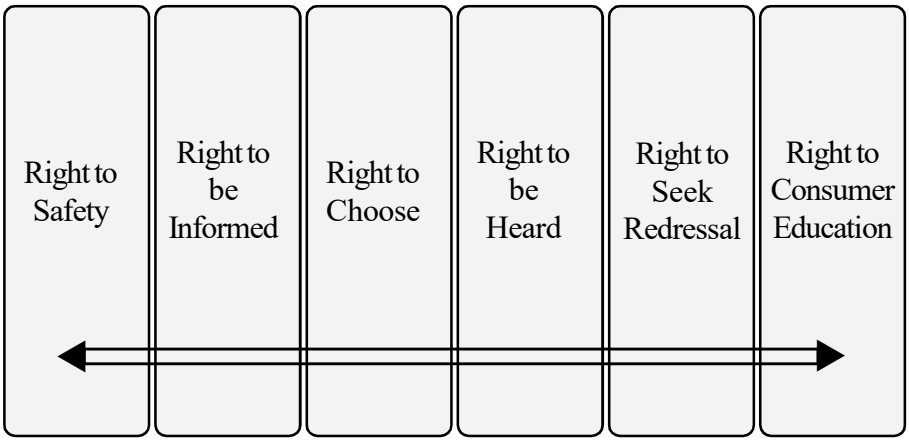


Fig. 17.1 Right of Consumers

1) Right to Safety

Right to Safety means right to be protected against the marketing of goods and services, which are hazardous to life and property. The purchased goods and services availed should not only meet their immediate needs, but also fulfil longterm interests. Before purchasing, consumers should insist on the quality of the products (ISI, AGMARK) as well as on the guarantee of the products and services.

2) Right to be Informed

Refers to the right to be informed about the quality, quantity, potency, purity, standard and price of goods so as to protect the consumer against unfair trade practices.This will enable him to desist from falling prey to high pressure selling techniques and act wisely.

3) Right to Choose

This means the right to be assured of access to a variety of goods and services at competitive prices. In case of monopolies, it means the right to be assured of satisfactory quality and service at a fair price.

4) Right to be Heard

It implies that the consumer's interests will receive due consideration atappropriate forums and they will be represented in various forums formed to consider the consumer's welfare.The Consumers should form non-political and non-commercial consumer organisations which can be represented in various committees formed by the Government and other bodies in matters relating to consumers.

5) Right to Seek redressal

This means the right to seek redressal against unfair trade practices or unscrupulous exploitation of consumers and the right to fair settlement of the genuine grievances of the consumer. Consumers must lodge complaints for their genuine grievances.

6) Right to Consumer Education

It implies that the consumer has a right to acquire the knowledge and skill to be an informed consumer throughout life.Ignorance of consumers, particularly of rural consumers, is mainly responsible for their exploitation.

20.5 RESPONSIBILITIES OF A CONSUMER

1. Consumer must Exercise his Right

Under Consumer Protection Act, the consumer is granted various rights such as right to safety, right to choose etc. But these rights will be useful only when theconsumer exercises these rights. The consumer must file a complaint,be aware of his rights and exercise them whenever required.

2. Cautious Consumer

The consumer should not believe the words of seller blindly. He must insist on getting full information about the goods or services.

3. Filing Complaints for the Redressal of Genuine Grievances

Most of the time consumer ignores the loss he suffers on purchase of defective good or service.The consumer must file a complaint even for a small loss. This awareness among consumers will make the sellers more conscious to supply quality product.

4. Consumer must be Quality-Conscious

The problems of supply of sub-standard goods, adulterated products and duplicate products can be solved only when the consumer looks for quality marks such as ISI mark, Agmark etc. while purchasing the goods or services.

5. Do not be carried away by Advertisements

The advertisements often exaggerate the qualities or features of product or service. The consumer must compare the actual use of the product with the use shown in advertisement and insist to stop showing exaggerated qualities if required.

6. Insist on Cash Memo

To file a complaint the consumer needs the evidence of purchase, and a cash memo is the proof that the consumer has paid for the goods or service. A seller is bound to give a cash memo even if the buyer does not ask for it.

7. Form consumer societies

Form consumer societies which could play an active part in educating consumers and safeguarding their interest and protecting them from exploitation by sellers .

8. Be environment friendly

The consumer must respect the environment; avoid waste littering and contribution to pollution.

20.6 WAYS AND MEANS OF CONSUMER PROTECTION

In India large numbers of consumers living below poverty line, are illiterate and unaware of their rights. So, consumer protection movement cannot be the same as followed by developed countries.In India it has to be a social movement wherein people of all walks of life have to play their role. Following are some ways and means of consumer protection followed in India:

1. Self-Regulation by Business

Large business houses have realised that they can prosper and grow for a long period of time only by giving due importance to consumers. Socially responsible firms follow quality standards and have started a customer grievance cell to attend the complaints of consumers.

2. Business Associations

Various business associations such as Federation of Indian Chamber of Commerce and Industry (FICCI) and Confederation of Indian Industry (CII) have framed codes of conduct which lay down guidelines for dealing with customers.

3. 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. It observes World Consumer Rights Day on 15 March and National Consumers Day on 24 December every year.

4. Consumer Organisations

Consumer organisations play an important role in educating consumers regarding their rights and duties. These organisations also help consumers to get relief in case of exploitation by the seller.

Examples of such organisations 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)

5. Government

The Government of India has framed a set of laws and legislations to protect the interests of consumers and the most important act framed by the government is Consumer Protection Act 2019. This Act has provided three tier redressal agencies, i. e., District Forum, National Commission and State Commission.

6. Lok Adalat

Lok Adalats are the effective and economical system for quick redressal of the public grievances. The aggrieved party can directly approach the adalats with his grievance, and his issues are discussed on the spot and decisions are taken immediately. 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 LokAdalats regularly to settle user's grievances on the spot.

7. 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.

8. 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, counselling and guidance mechanisms, product testing labs, and so on.

9. 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.

20.7 CONSUMER PROTECTION ACT

The Consumer Protection Act was first passed in 1986 and it came into force from 1 July 1987. The new Consumer Protection Act 2019 received the assent of the President on the 9th August, 2019 and was enforced on 20th July, 2020.The basic aim of the Consumer Protection Act, 2019 is to save the rights of the consumers by establishing authorities for timely and effective administration and settlement of consumers' disputes.

Key features of the Consumer Protection Act, 2019

1. Establishment of the Central Consumer Protection Authority (CCPA)

The Act has the provision of the establishment of the CCPA which will protect, promote and enforce the rights of consumers. The CCPA will regulate cases related to unfair trade practices, misleading advertisements, and violation of consumer rights.

The CCPA will have the right to impose a penalty on the violators and passing orders to recall goods or withdraw services, discontinuation of the unfair trade practices and reimbursement of the price paid by the consumers. The Central Consumer Protection Authority will have an investigation wing to enquire and investigate such violations. The CCPA will be headed by the Director-General.

2. Rights of consumers

i. To have information about the quantity, quality, purity, potency, price, and standard of goods or services.

ii. To be protected from hazardous goods and services.

iii. To be protected from unfair or restrictive trade practices.

iv. To have a variety of goods or services at competitive prices.

3. Prohibition and Penalty for a Misleading Advertisement

The Central Consumer Protection Authority (CCPA) will have the power to impose fine on the endorser or manufacturer of up to 2-year imprisonment for misleading or false advertisement (e.g. Laxmi Dhan Warsha Yantra). Worth to mention that repeated offense, may attract a fine of Rs 50 lakh and imprisonment of up to 5 years.

4. Consumer Disputes Redressal Commission

The act has the provision of the establishment of the Consumer Disputes Redressal Commissions (CDRCs) at the national, state and district levels.

The CDRCs will entertain complaints related to;

i. Overcharging or deceptive charging

ii. Unfair or restrictive trade practices

iii. Sale of hazardous goods and services which may be hazardous to life.

iv. Sale of defective goods or services

5. Covers E-Commerce Transactions

The New Act has widened the definition of 'consumer'. The definition now includes any person who buys any goods, whether through offline or online transactions, electronic means, teleshopping, direct selling or multi-level marketing. The earlier Act did not specifically include e-commerce transactions, and this lacuna has been addressed by the New Act.

6. Enhancement of Pecuniary Jurisdiction

Revised pecuniary limits have been fixed under the New Act. Accordingly, the district forum can now entertain consumer complaints where the value of goods or services paid does not exceed INR 10,000,000 (Indian Rupees Ten Million). The State Commission can entertain disputes where such value exceeds INR 10,000,000 (Indian Rupees Ten Million) but does not exceed INR 100,000,000 (Indian Rupees One Hundred Million), and the National Commission can exercise jurisdiction where such value exceeds INR 100,000,000 (Indian Rupees One Hundred Million).

7. E-Filing of Complaints

The New Act provides flexibility to the consumer to file complaints with the jurisdictional consumer forum located at the place of residence or work of the consumer. This is unlike the current practice of filing it at the place of purchase or where the seller has its registered office

address. The New Act also contains enabling provisions for consumers to file complaints electronically and for hearing and/or examining parties through video-conferencing. This is aimed to provide procedural ease and reduce inconvenience and harassment for the consumers.

8. Establishment of Central Consumer Protection Authority

The New Act proposes the establishment of a regulatory authority known as the Central Consumer Protection Authority (CCPA), with wide powers of enforcement. The CCPA will have an investigation wing, headed by a Director- General, which may conduct inquiry or investigation into consumer law violations. The CCPA has been granted wide powers to take suo-moto actions, recall products, order reimbursement of the price of goods/services, cancel licenses and file class action suits, if a consumer complaint affects more than 1 (one) individual.

9. Product Liability & Penal Consequences

The New Act has introduced the concept of product liability and brings within its scope, the product manufacturer, product service provider and product seller, for any claim for compensation. The term 'product seller' is defined to include a person who is involved in placing the product for a commercial purpose and as such would include e-commerce platforms as well. The defense that e-commerce platforms merely act as 'platforms' or 'aggregators' will not be accepted. There are increased liability/ risks for manufacturers as compared to product service providers and product sellers, considering that under the New Act, manufacturers will be liable in product liability action even where he proves that he was not negligent or fraudulent in making the express warranty of a product. Certain exceptions have been provided under the New Act from liability claims, such as, that the product seller will not be liable where the product has been misused, altered or modified.

10. Unfair Trade Practices

The New Act introduces a special broad definition of Unfair Trade Practices, which also includes sharing of personal information given by the consumer in confidence, unless such disclosure is made in accordance with the provisions of any other law.

11. Provision for Alternate Dispute Resolution

The New Act provides for mediation as an Alternate Dispute Resolution mechanism, making the process of dispute adjudication simpler and quicker. This will help with the speedier resolution of disputes and reduce pressure on consumer courts, who already have numerous cases pending before them.

20.8 WHO CAN FILE A COMPLAINT?

The following persons can file a complaint under Consumer Protection Act 2019:

(a) one or more consumers;

(b) any recognised voluntary consumer association whether the consumer is a member of that association or not;

(c) the Central or any State Government;

(d) one or more consumers where there are numerous consumers having the same interest.

(e) legal heir or representative in case of death of a consumer; and

(f) where the consumer is a minor, the complaint can be filed by his parent or legal guardian.

20.9 FILING OF A CONSUMER COMPLAINT

Before filing the complaint with the consumer forum it is advised that the consumer gives notice to another party about a defect in the product (goods or services) etc. and see whether the other party is willing to pay the damages or replace the product. If it is done, then the dispute is settled then and there. But if the other party neglects or refuses, then the consumer needs to approach the respective forum and file the complaint.

Before filing the complaint, consumer first needs to decide in which jurisdiction of consumer forum his case lies.

Jurisdiction of Consumer Forums

The consumer should file his complaint to a consumer forum which has both territorial and pecuniary jurisdiction to decide the matter.

Territorial Jurisdiction Complaint should be instituted with a district forum (section 11), state commission (section 17) or National Commission (section 21) within the local limits of whose jurisdiction the case lies.

Pecuniary Jurisdiction Consumer complaints can be filed with respect to value enumerated as below:

- District forum - up to 1 crore
- State Commission - 1 crore to 10 crores
- National Commission - more than 10 crores

The procedure of complaint filing in Consumer Forums:

Step 1. The complaint can be made on simple paper, stamp paper is not necessary for it.

Step 2. The complaint should be drafted stating the facts necessary for establishing the cause of action. Following things needs to be mentioned in complaint by the consumer:

a) Name and complete details of the complainant and opposite party or parties.

b) Date and time of purchase of goods or services availed and the amount paid for them.

c) Particulars of dispute; like a defect in goods or inferior quality of service etc.

d) Particulars of the relief sought in the complaint.

e) Particulars of goods purchased with numbers or details of services availed.

f) Copies of all those documents can be attached which support the contention of the consumer and are necessary to establish the cause of action like a copy of bills of goods bought or service availed, warranty receipt, copy of the complaint made to the trader asking to compensate for the loss.

Step 3. The compensation claimed should be specified in the complaint and along with it, the consumer can also ask for refunds, damages,litigation expenditure etc. But these amount should be detailed under different heads and in accordance with pecuniary jurisdiction of respective consumer forums.

Step 4. The statement of jurisdiction should be made in the complaint as to how the case falls within the jurisdiction of the consumer forum.

Step 5. A verification affidavit should be affixed with the complaint stating that all the facts and claims made in the complaint are true and correct.

Step 6. At the end of the complaint, the signature should be put. The consumer may argue his case on his own or through his authorized representative. The complaint made with the district forum or state commission needs to be filed in three sets and when made with the national commission needs to be filed in four sets with additional sets for each opposite party.

Step 7. The complaint has to be filed within two years from the date on which the cause of action arose. In case of delay sufficient reasons have to be given to the forum so it may allow the complaint to be filed.

What complaints can be filed?

"Complaint" means any allegation in writing, made by a complainant for obtaining any relief provided by or under this Act, that-

(i) an unfair contract or unfair trade practice or a restrictive trade practice has been adopted by any trader or service provider;

(ii) the goods bought by him or agreed to be bought by him suffer from one or more defects;

(iii) the services hired or availed of or agreed to be hired or availed of by him suffer from any deficiency;

(iv) a trader or a service provider, as the case may be, has charged for the goods or for the services mentioned in the complaint, a price in excess of the price:

- fixed by or under any law for the time being in force; or

- displayed on the goods or any package containing such goods; or

- displayed on the price list exhibited by him by or under any law for the time being in force; or

- agreed between the parties;

(v) the goods, which are hazardous to life and safety when used, are being offered for sale to the public:

- in contravention of standards relating to safety of such goods as required to be complied with, by or under any law for the time being in force;

- where the trader knows that the goods so offered are unsafe to the public;

(vi) the services which are hazardous or likely to be hazardous to life and safety of the public when used, are being offered by a person who provides any service and who knows it to be injurious to life and safety;

(vii) a claim for product liability action lies against the product manufacturer, product seller or product service provider, as the case may be;

What are the reliefs available to consumers?

Depending on the nature of complaint and the 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.

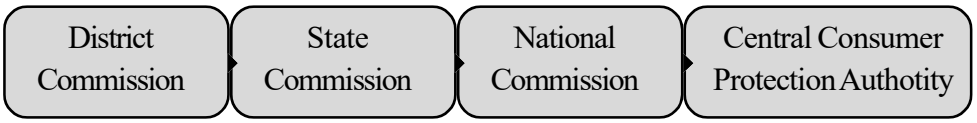
(f) Withdrawal of hazardous or dangerous goods from being offered for sale.

(g) Provision of adequate refund to aggrieved parties.

Time limit for filing the case

The complaint should not be raised through a registered or regular post. It should be filed within 2 years of the date on which the dispute arose. The complainant is required to file four copies of the complaint and additional copies for each opposite party.

20.10 MACHINERY FOR SETTLEMENT OF GRIEVANCES



1. District Forum

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

(a) Composition

Each District Commission shall consist of- (a) a President; and (b) not less than two and not more than such number of members as may be prescribed, in consultation with the Central Government.

(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. 1 crore .

(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: Each State Commission shall consist of-

(1) a President; and

(2) not less than four or not more than such number of members as may be prescribed in consultation with the Central Government

(b) Jurisdiction: A written complaint can be filed before the State Commission where the value of goods or services and the compensation claimed exceed Rs. One crore but does not exceed Rs.ten crores.

(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.

(a) Composition: The National Commission shall consist of-

(1) a President; and

(2) not less than four and not more than such number of members as may be prescribed.

(b) Jurisdiction: All complaints pertaining to those goods or services and compensation whose value is more than Rs. ten crores 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.

4. Central Consumer Protection Authority:

(This concept has already been explained under 20.7 Consumer Protection Act)

TERMINAL EXERCISE

Very Short Answer Questions

1. Give the meaning of a 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. Mention any four standard quality certification marks.
6. What kind of cases can be filed in a State Commission?

Short Answer Questions

1. Explain the composition and jurisdiction of the state commission.
2. State the purpose of creating the Consumer Welfare Fund.
3. Who can file a complaint for redressal of grievances under the Consumer Protection Act 2019?
4. State any three responsibilities that a consumer should keep in mind while making a purchase.
5. Explain ways and means of consumer protection in India.

Long Answer Questions

1. Explain the needs for consumer protection.
2. Describe the right of a consumer as per CPA . Explain the role of consumer organisation for consumer protection.
3. Briefly explain the importance of consumer protection to customers.
4. 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?
5. Explain the redressal mechanism available to consumers under the Consumer Protection Act 2019.

QUESTION PAPER DESIGN (319)

Subject : Commerce / Business Studies | Level : Intermediate

Maximum Marks : 100 | Time : 3 hours

1. Weightage by Objectives

OBJECTIVES	MARKS	% OF TOTAL MARKS
KNOWLEDGE	30	30%
UNDERSTANDING	40	40%
APPLICATION	30	30%
TOTAL	100	100%

2. Weightage by type of questions

Question Types	No. of Questions	Marks for Question	Total Marks
Long Answer Questions	5	8	40
Short Answer Questions	9	4	36
Very Short Answer Questions	12	2	24
TOTAL	26		100

Long answers questions – Out of 9 only 5 questions to be answered, In short answer questions out of 14 only 9 to be answered. No choice for VSA questions.

3. Weightage by contents

		Marks				No. of Questions		
Sl.No	Module	Total	LA	SA	VSA	LA	SA	VSA
1	Introduction to Business (5 lessons)	16	8	4	4	2	2	2
2	Business Management & its Functions (4 lessons)	24	8	12	4	2	5	2
3	Business Finance (4 lessons)	24	8	12	4	2	4	2
4	Trade (2 lessons)	16	8	4	4	1	2	2
5	Awareness in Business and Employment (5 lessons)	20	8	4	8	2	2	4
	Total	100	40	36	24	9	14	12

4. Difficulty Level of the question paper

LEVEL	%	MARKS
DIFFICULT	25%	25
AVERAGE	45%	45
EASY	30%	30
Total	100%	100

TOSS COMMERCE (319)

MODEL QUESTION PAPER

Time: Hours Max Marks: 100

I. Answer any five of the following questions.
Each question carries 8 marks. 5 X 8 = 40M

1. Define Industry ? How do you classify different types of industries?
2. Explain the primary functions of commercial banks ?
3. Write the functions of management ?
4. Write the steps in planning ?
5. What are the essentials of sound financial plan ?
6. Explain the determinants of working capital of a firm ?
7. Write the difference between wholesale trade and retail trade ?
8. Write the sources of information about job vacancies ?
9. Explain the consumer rights ?

II. Answer any 9 of the following questions. Each question carries 4 marks. 9*4=36M

10. Define partnership deed ? Write any two contents of it ?
11. Write the steps in the formation of Joint stock company ?
12. What is meant by scientific management?
13. Write the different elements of delegation?
14. Write the steps in selection process ?
15. Write about personal barriers of communication ?
16. Write any four objectives of financial planning ?
17. Write the differences between GDR and ADR ?
18. Write the types of financial markets ?
19. Write any two functions of stock exchange ?
20. Write the merits of super markets ?

21. Write the importance of external trade ?

22. Write any two functions performed by placement agencies ?

23. Write about e-business ?

III. Answer all the questions.
Each question carries 2 marks 12 X 2 = 24 M

24. Insurance

25. Business ethics

26. Management

27. Recruitment

28. Dividend

29. Lease financing

30. Entrepot trade

31. WTO

32. Self employment

33. Resume

34. NSDC

35. Consumer