

# Nature and Significance of Management

# 1

## Management

“Management is defined as the process of planning, organizing, actuating and controlling an organization’s operations in order to achieve coordination of the human and material resources essential in the effective and efficient attainment of objectives.”

### Concept of Management:

Management is a process that aims to bring the efforts of the people working in the organization to achieve a common objective effectively and efficiently.

1. Traditional Concept Management is the art of getting things done through others.
2. Modern Concept Management is defined as the process (refers to the basic steps) to get the things done with the aim of achieving goals effectively and efficiently (effectiveness refers to achievement of task on time and efficiently implies optimum use of resources).



**Process:** The term process refers to the primary activities performed in an organization by the management to achieve the objective. It includes planning, organizing, staffing, directing and controlling.

**Effectively:** The term effectively refers to completion of the given task in the allotted time frame.

**Efficient:** The term efficient means completing the task within minimum cost as well as optimum utilization of resources.

### Characteristics of Management:

1. Management is a Goal Oriented Process Organisation’s existence is based on objectives and management is the process which unites the efforts of every individuals to achieve the goal.
2. Management is All Pervasive The use of management is not restricted, it is applicable in all organisations big or small, profit or non-profit making.
3. Management is Multidimensional it does not contain one activity. it is a complex activity including three main activities:
  - Management of house.
  - Management of people.
  - Management of operations.
4. Management is a Continuous Process It is a never ending process. It consists of series of interrelated



functions which performs continuously.

- Management is a Group Activity Organisation is a collection of many individuals, every individual contributes towards achieving the goal.
- Management is an Intangible Force It cannot be seen or touched only it can be felt in the way the organisation functions.

### Functions of Management:

- Planning:** Planning is a process of setting goals and objectives and formulating a strategy and an action plan to achieve it. It bridges the gap between our current position and desired position. This is the basic function of an organization and is the first step of management.
- Organizing:** Organizing is the process of establishing authority and responsibility relationships. It involves assigning tasks to individuals and allocating resources for the same.
- Staffing:** Staffing is a process of placing the right person on the right job at the right time. It includes recruitment, selection, placement, induction and training of employees. It can be called as the Human Resource function of the organization.
- Directing:** Directing refers to the process of leading, influencing and motivating the individuals working in the organization to complete the assigned task effectively and efficiently. The employees need to be constantly motivated to perform better. Leadership and motivation are the key components of directing as a function. It tends to bring out the best in an employee.
- Controlling:** Controlling is the process of keeping a check on the performance of the organization and comparing it with the standards set. Also, corrective actions are taken, in case any deviation is found between the actual and desired results.



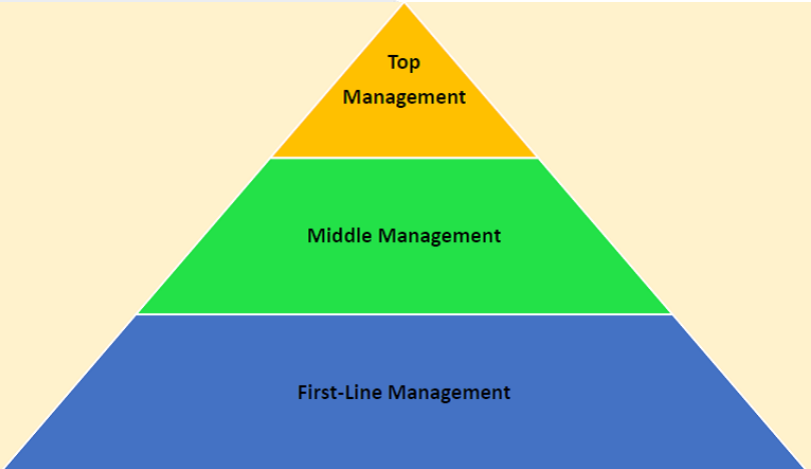
### Importance of Management:



The importance of management can be understood from the following points:

1. **Management helps in achieving group goals:** Management creates teams and coordinates with individuals to achieve individual goals along with organizational goals.
2. **Increases efficiency:** Management increases efficiency by using resources in the best possible manner to reduce cost and increase productivity.
3. **Creates dynamic organization:** Management helps the employees overcome their resistance to change and adapt as per changing situation to ensure its survival, growth and its competitive edge.
4. **Achieving personal objectives:** Through motivation and leadership management helps the individuals in achieving personal goals while working towards organizational objective.
5. **Development of society:** Management helps in the development of society by producing good quality products, creating employment opportunities and adopting new technologies.

### Levels of Management:

1. **Top Management:** Designations and Functions Comprises of CEO, Board of Directors, MD, GM, VP. Main task is conceptualizing of organizational goal, policy and strategy formulation and organising, controlling, and monitoring activities and resources. Controlling the work performance of individuals and approving Budgets.
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2. **Middle Management:** Designations and Functions Comprises of Departmental, Sub-Departmental and Divisional heads, its main task is execution of plans, policies framed by the top-level management and preparing organisational set up & appointing employees and issuing instructions and motivating employees. Ensuring interdepartmental cooperation as well.
  3. **First-line Management:** Designations and Functions Consists of Foremen and supervisor etc. Main task is to ensure actual implementation of the policies as per directions of top and middle level managers and also to Bring workers' grievances before the management & maintain discipline among the workers.

### Co-ordination:

The Essence of Management Co-ordination means binding together all the activities such as purchase, production. sales finance to ensure continuity in the working of the organisation. It is considered as a separate function of management, in order to achieve harmony among individual. efforts towards the accomplishment of goods.



### Characteristics of Co-ordination

1. It integrates group efforts.
2. It ensures units of action.
3. It is a continuous process.
4. It is an all pervasive function.
5. It is the responsibility of all managers.



## Features of Coordination:

1. **Coordination Integrates Group Effort:** It is an orderly arrangement of group effort to ensure that performance is at par with the plans and schedules.
2. **Coordination Integrates Group Effort:** It is an orderly arrangement of group effort to ensure that performance is at par with the plans and schedules.
3. **Coordination is a Continuous Process:** It is a never-ending process as its needs are felt at all levels and in all activities in the organisations. It begins at the planning stage and continues until controlling.

## Coordination is the responsibility of all managers:

Coordination is equally important at all levels of management. It is the responsibility of all the individuals in an organisation to carry out their work in a responsible manner and coordinate with each other to achieve organizational goals.

1. **Coordination is a deliberate function:** A manager has to coordinate the efforts of different people in a conscious and deliberate manner.
2. **Coordination is all pervasive function:** It is needed in all departments and at all levels. Lack of coordination can lead to overlapping of activities.

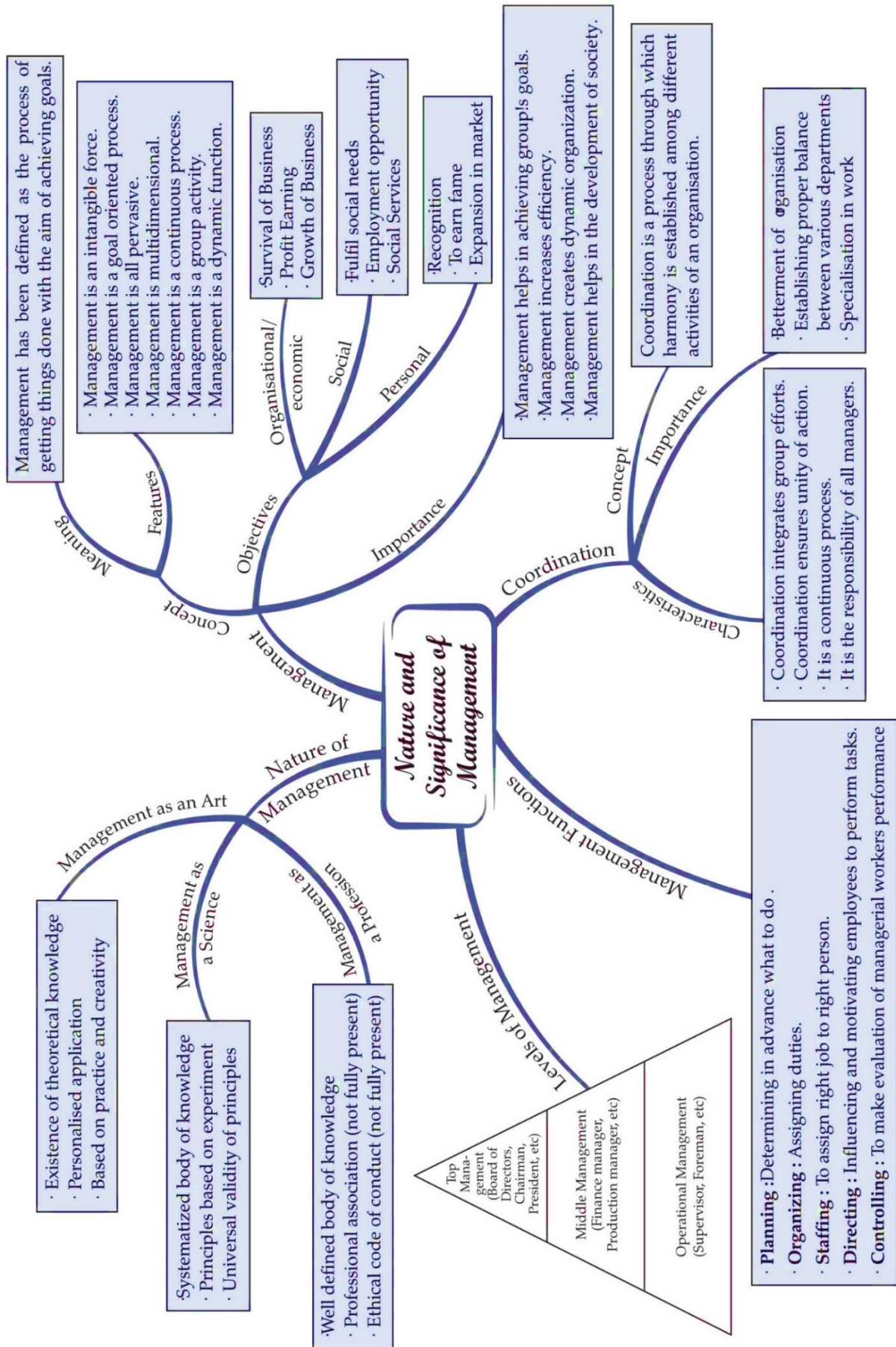


## Importance of Coordination:



1. **Growth in Size:** Coordination harmonizes individual goals with the organizational goals. This results in the growth of the organization which results in an increase in the number of people employed with it.
2. **Functional Differentiation:** The various departments of the organization have their own objectives, policies and their own style of working. But to achieve organizational objective coordination is important so as to link the activities of all departments.
3. **Specialization:** Coordination integrates all the specialists activities into a collective effort.

# CHAPTER - 1 NATURE AND SIGNIFICANCE OF MANAGEMENT





## Important Questions

### Multiple Choice Questions

- Which one of the following is not an objective of Management?
  - Political Objective
  - Social Objective
  - Organisational Objective
  - Personal Objectives
- Management is \_\_\_\_\_.
  - Wastage of time
  - Multi-Dimensional
  - Not required in small business firms
  - Individual Activity
- Management is a \_\_\_\_\_ Activity.
  - Group
  - Supervisor Level
  - Accounting
  - Individual
- The word \_\_\_\_\_ denotes a function, a task, a discipline.
  - Management
  - Leadership
  - Motivation
  - None of the above
- Mainly planning is concerned with \_\_\_\_\_.
  - Formulation of Policies and Strategies
  - Management in Action
  - Manpower Planning
  - None of the above
- A process needs
  - Throughout to execute
  - Timer to execute
  - Resources to execute
  - Both a and b
- Coordination is:
  - The essence of management
  - Function of Management
  - An objective of management
  - None of the above
- Providing the facility for Schools and hospitals is the \_\_\_\_ objective of management.
  - Social Objectives
  - Organisational Objective
  - Personal Objective
  - None of the above
- Organisational objective is not concerned with \_\_\_\_\_.
  - Growth
  - Profit
  - Survival
  - Supply of quality goods
- Which of the following is not an example of non-economic activity?
  - Patriotism
  - Teaching
  - Sentiment
  - Sympathy
- Effectiveness is concerned with \_\_\_\_\_.
  - Doing the task correctly with minimum cost
  - Getting things done with the aim of achieving goals effectively and efficiently
  - Doing the right task, completing activities, and achieving goals
  - None of the above
- Which aspect of management is concerned with the end result?
  - Co-ordination
  - Efficiency
  - Effectiveness
  - Controlling
- Pramod Limited targets production of 22,000 units in a year. The production manager was able to cut down the cost but could not achieve the target. In this case, manager is \_\_\_\_\_ but not \_\_\_\_\_.
  - Efficient but not honest
  - Effective but not efficient
  - Efficient but not effective
  - None of the above

14. Water pollution can be identified by testing its
  - (a) PH level
  - (b) Biological Oxygen Demand (BOD)
  - (c) Both (a) and (b)
  - (d) None of the above
15. Which of the following is not included in Top Level Management?
  - (a) Accountant
  - (b) Managing Director
  - (c) Chief Executive
  - (d) Board of Directors

### Very Short –

1. “Planning, Organizing, Staffing, Directing and controlling” is the sequence of functions in a process. Name it.
2. Name that intangible force which creates productive relationships among resources of an organization.
3. What is the main objective of any organization?
4. Production manager tries to produce goods with minimum costs. Name the concept which is being focused by management?
5. What do you mean by effectiveness?
6. “Management is a group activity”. Give reasons for statement.
7. In order to be successful, an organization must change its according to the needs of the environment. Which characteristic of management is highlighted in the statement?
8. Give one designation each of top and middle level management?
9. Your Grand Father has retired as the director of a manufacturing company. At what level of management was he working?
10. Why is management called inexact science?

### Short Questions –

1. Explain the meaning of management. What do you mean by managers?
2. ‘Management is a process’ Explain?
3. ‘Management is multi-dimensional’. Explain?
4. What are the personal objectives of the management?
5. Enumerate the importance of management.
6. What do you mean by level of management?
7. Define co-ordination. Enumerate the features of co-ordination?

8. Distinguish between coordination and cooperation.
9. Write the characteristics of management and explain any two.
10. “Lack of proper management results in wastage of time money and efforts.” Do you agree with this statement? Give reasons in support of your answer. (2003)

### Long Questions-

1. Explain any five features of management?
2. Explain the organizational objectives of management.
3. Explain the ‘social objectives’ of management.
4. Do you mean by ‘Personal Objectives’ of management? Enumerate personal objectives of management.
5. Explain five functions of top-management.
6. Do you think proper Management is an important part of an organization?  
or  
Explain the importance of management.
7. Explain the level of management and their main functions.

### Case Study Based Question-

1. Josh Enterprises decides to have a meeting of all the key employees of different departments in the organisation. The main motive is to tell the employees to keep the target of 20% increase in sales as the main objective when they work throughout the year. The meeting is full of ideas regarding the employees and processes involved. Various plans are made to harness the potential of the employees and streamline the processes. However with the passage of a few days the external business environment checks the capability of the organisation to adapt to the situations. The company successfully comes out at the end of the year with flying colours.  
What are the various characteristics of management you can find highlighted here? Also identify the lines in which these characteristics have been highlighted.
2. XYZ Ltd. is a management oriented company. Time and again all the employees learn from their seniors various ways of dealing with diverse situations. They are provided training whenever required. They are also given incentives both



financial as well as non financial. The result is employees see their development in the organisation. The organisation tries to behave as a responsible constituent of society and always creates good quality products. It has a very good image in the market. The training modules are superb and the employees always try to find unique ways of providing solutions in the context of rapidly changing business environment. This has helped the organisation to adjust frequently in a very good manner.

Which importance of management is highlighted here? Also identify the lines.

### Assertion Reason Question-

- In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.
  - Assertion and reason both are correct statements and reason is correct explanation for assertion.
  - Assertion and reason both are correct statements but reason is not correct explanation for assertion.
  - Assertion is correct statement but reason is wrong statement.
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**Assertion (A):** Efficiency aims at performing tasks with the least wastage of time and effort.

**Reason (R):** Efficiency is about doing the job in a cost-effective manner, i.e., getting maximum output with minimum input.

## Answer Key

### MCQ Answers

- Answer:** (a) Political Objective
- Answer:** (b) Multi-Dimensional
- Answer:** (a) Group
- Answer:** (a) Management
- Answer:** (a) Formulation of Policies and Strategies
- Answer:** (c) Resources to execute
- Answer:** (a) The essence of management
- Answer:** (a) Social Objectives
- Answer:** (d) Supply of quality goods
- Answer:** (b) Teaching
- Answer:** (c) Doing the right task, completing activities, and achieving goals
- Answer:** (c) Effectiveness
- Answer:** (c) Efficient but not effective

14. **Answer:** (c) Both (a) and (b)

15. **Answer:** (a) Accountant

### Very Short Answer –

- Ans.** Management
- Ans.** Management
- Ans.** Main objective of any organization is optimum utilization of resources
- Ans.** Efficiency
- Ans.** It means completing the task or achieving the goals within stipulated time period.
- Ans.** An organization is a collection of diverse individuals with needs and purposes but they work towards fulfilling the common organizational goals.
- Ans.** Management is a dynamic function.
- Ans.** Top – CEO, Middle – Divisional Manager



- 9. **Ans.** Top management.
- 10. **Ans.** Management relates to human behavior, whose cause and effect is not certain, that's why it is called and inexact science.

**Short Answers -**

- 1. **Ans.** Management is a process of getting things done with the aim of achieving desired common goals effectively and efficiently persons engaged in performing the functions of the management are known as managers. In other words, those managing the organizational resources for releasing its goals are known as managers.
- 2. **Ans.** Management includes various steps such as planning, organizing, staffing, directing and controlling. This process begins with those at the top of the organization and continues in varying degrees at almost every level of the organization. These inter-related steps help to achieve organizational goals in effective manner. That is why management is known as process of employing and organizing resources to accomplish predetermined objectives.
- 3. **Ans.** Management is a complex activity and involves following three main dimensions -
  - i) Management of works**  
In each and every organization, certain type of work is to be performed. In school, overall development of a child is to be done; in hospitals, patients are treated etc. Management converts these works into goals and devises the means to achieve them.
  - ii) Management of People.**  
Management is concerned with "getting things done through people", which is a very difficult task. All the employees have different personalities, needs backgrounds and methods of work. Thus, it becomes management's job to make them work as a group by giving common direction to their efforts.
  - iii) Management of operations.**  
In order to survive, each organization has to provide certain goods or services. This involves production process thus, management of operations is inter linked with both the above dimensions viz., management of work and the management of people.
- 4. **Ans.** Personal objectives refer to the objectives which are related to the employees of an organization. They are as follows:

- i) Financial needs like competitive salaries, incentives and other monetary benefits.
- ii) Social needs like recognition in the organization.
- iii) Higher level need which includes personal growth and development.
- 5. **Ans.** Following points are the importance of management.
  - i) Management helps in achieving group goals.
  - ii) Management increase efficiency
  - iii) Management creates a dynamic organization.
  - iv) Management helps in achieving personal objectives.
  - v) Management helps in development of society.
- 6. **Ans.** Levels of management means the hierarchy of organization representing the relationships among managers and subordinates on the basis of their relative authority, status and responsibility. There are three levels in the hierarchy of an organization viz.
  - (i) Top management, (ii) Middle management and (iii) Supervisory or operational management.
- 7. **Ans.** Coordination is an orderly arrangement of group efforts to maintain harmony among individuals' efforts towards the accomplishment of common goals of an organization.

**Features of co-ordination**

- i) It integrates group efforts.
- ii) It unifies the action.
- iii) It is a continuous process.
- iv) It is an all-pervasive function
- v) It is the responsibility of all managers.
- vi) It is a deliberate function.
- 8. **Ans.**

Co-ordination	Cooperation
1. It is an orderly arrangement of a group effort to provide for unity of action.	1. It is a voluntary desire to help each other
2. Co-ordination includes cooperation; hence it is a wider term.	2. Co-operation is a narrow term as it is a part of co-ordination.



3. It is a deliberate effort made by the management to balance interrelated activities.	3. It is the voluntary effort made by a group of people depending on their mental needs or liking
4. It is a technique.	4. It is an attitude.

9. **Ans.**

Characteristics The key features of management are –

1. Goal-oriented process,
2. all-pervasive,
3. multidimensional,
4. Continuous process,
5. group activity
6. dynamic function,
7. tangible force.

1. Management is a goal-oriented process: An organization has a set of basic goals which are the basic reason for its existence. These should be simple and clearly stated.
2. Management is all-pervasive: The activities involved in managing an enterprise are common to all organizations whether economic, social, or political Thus it is all-pervasive.

10. **Ans.**

Yes, the above-mentioned statement holds true as the reasons are as follows.

1. **Means to accomplishing goals:** Management is important because it helps in achieving group goals, increases efficiency, and creates a dynamic organization.
2. **Unified direction:** Management motivates and directs the workforce by unifying goals with the group goals.
3. **Establishes sound industrial relations:** The success of any organization depends upon its workforce. It is the only factor of production which is movable in nature. Effective management tries to build a feeling of team and loyalty towards the organization.
4. **It looks after for future uncertainties:** An effective management prepares the organization for future contingencies and paved the way for its survival and growth. In

the 'absence of this foresightedness, an organization may be forced to wind up its operations resulting in wastage of time, efforts, and resources.

### Long Answers

1. **Ans.** Following are the features of management:

**(i) Management is a group activity**

Management consists of a number of persons who work as a group.

Their efforts are directed towards the common goals. Members initiate, communicate, coordinate and join their hands for the achievement of organizational objectives.

**(ii) Management is a goal-oriented process**

Management aims at common goals through a process of series of continuous functions via planning, organizing, directing, staffing and controlling. These composite functions of management are separately performed by all managers all the time simultaneously to realize organizational goals

**(iii) Management is all pervasive**

Whether it is a commercial organization or noncommercial organization, big or small all require management to handle their operations effectively and efficiently.

**(iv) Management is a continuous process**

Management is a continuous process consisting of a series of functions viz., planning, organizing, directing and controlling. All the managers perform these functions regularly.

**(v) Management is a dynamic function**

The environment in which a business exists keeps on changing. Thus in order to be successful, management must change its goals, plans and politics according to the needs of its environment.

2. **Ans.** The organizational objectives of management refer to the main objectives required to fulfill the economic goals of the business organization. The main objective of management is to utilize the human and material resources in such a manner that it should give maximum advantage to the organization. Every management group strives to accomplish these objectives for its organization.

These objectives of every organization are survival, profit and growth:

- (a) **Survival:** The basic objective of every business is to survive for a longer period in the market. The management must ensure survival of the organization by earning enough revenue to cover its costs.
- (b) **Profit:** Only survival is not sufficient for business. Profit earning is essential for meeting the expenses and for the successful operation of the bus' Thus management must ensure earning of sufficient profit.
- (c) **Growth:** The next important objective of the management is to ensure future growth and development of the business.

3. **Ans.** Each organization is a part of society and thus it has certain social obligations to fulfill.

Some of them are as follows:

- (i) To supply quality goods and services
- (ii) Providing basic amenities to the employees like schools and creches for their children, medical facilities etc.
- (iii) To generate employment opportunities especially for the backward classes.
- (iv) To provide environment friendly methods of production.
- (v) To provide financial support to society by donating for noble causes.
- (vi) To organize educational, health and vocational training programmes.
- (vii) To participate in social service projects of Government and Non - Governmental Organizations (NGOs).

4. **Ans.** Personal Objectives refer to the objectives which are related to the individual needs of the employees of an organization. All organizations are made up of people with different values, experiences and objectives. People join an organization to satisfy their different needs. These are as follows:

- i) Financial needs like competitive salaries, incentives and other monetary benefits.
- ii) Social needs like recognition in the organization.
- iii) Higher level need which includes personal growth and development.

5. **Ans.** Top management performs the following functions.

- i) **Develops long-term objectives:** Top-level managers develop the long - term objectives like expansion of business, manpower planning etc.
- ii) **Framing of policies:** They lay down guidelines for departmental head i.e., policies relating to production, marketing, personnel, finance public relation etc.
- iii) **Organizing:** Top management organizes the business into various sections and departments to achieve the desired organizational objectives.
- iv) **Key appointments:** Top-level authorities appoint the departmental heads and some other key persons to develop the organizational structure for profitable growth of the enterprises.
- v) **Controlling:** Top-level managers periodically review the work of executives at different levels to ensure that their performance is as per predetermined plans.

6. **Answer:**

Yes, management is a universal activity that is integral to any organization. We now examine some of the reasons that have made management so important.

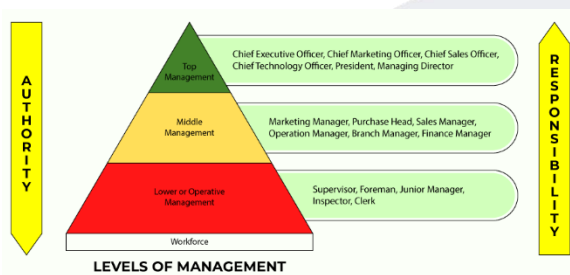
1. **Management helps in achieving group goals:** Management is required not for itself but for achieving the goals of the organization, the task of a manager is to give a common direction to all.
2. **Management increases efficiency:** The aim of a manager is to reduce costs and increase productivity " through better planning, organizing directing, staffing, and controlling the activities of the organization.
3. **Management creates a dynamic organization:** All organizations have to function in an environment that is constantly changing.
4. **Management helps in achieving personal objectives:** A manager motivates and leads his team in such a manner that individual members are able to achieve personal goals while contributing to the overall organizational objective.



5. **Management helps in the development of society:** An organization has multiple objectives to serve the purpose of the different groups that constitute it. In the process of fulfilling all these management helps in the development of the organization and through that it helps in the development of society. It helps to provide good ' quality products and services, creates employment opportunities, and leads the path towards growth and development.

7. **Answer:**

Level of Management.



Generally speaking, there are three levels in the hierarchy of an organization.

1. **Top Management:**

They consist of the senior-most executives of the organization by whatever name they are called. They are usually referred to as the chairman, the chief executive officer, chief operating officer, president, and vice-president. Top management is a team consisting of managers from different functional levels. Their basic task is to integrate diverse elements and coordinate the activities of different departments according to the overall objectives of the organization. They are responsible for the welfare and survival of the organization. Their job is complex and stressful.

2. **Middle Management:**

It is the link between top and lower-level management. They are subordinate to top managers and superior to the first-line managers. They are usually known as division heads, operation managers, or plant superintendent. They are responsible for implementing and controlling plans

developed by top management. At the same time, they are responsible for all the activities of first-line management. Their main task is to carry out the plans formulated by the top management and at the same time, they are responsible for all the activities of first-line managers.

3. **Operational Management:**

Foreman and supervisors comprise the lower level in the organization. Supervisors directly oversee the efforts of the workforce. Their authority and responsibility are limited according to the plans drawn by the top management. They play a very important role in the organization since they interact with the actual workforce and pass on instructions of the middle management to the Workers. Through the quality of their efforts of output is maintained. Wastage of materials is minimized and safety.

**Case Study Answer-**

1. **Answer:**

The various characteristics of management involved here are:

**Goal Oriented:** The main motive is to tell the employees to keep the target of 20% increase in sales as the main objective when they work throughout the year.

**Multidimensional:** Various plans are made to harness the potential of the employees and streamline the processes. Employees—People and Streamline the process—Operations.

**Dynamic:** However with the passage of a few days the external business environment checks the capability of the organization to adapt to the situations.

2. **Answer:**

The importance of management highlighted here are:

**Development of personnel:** They are also given incentives both financial as well as non financial. The result is employees see their development in the organisation.



**Development of society:** The organisation tries to behave as a responsible constituent of society and always creates good quality products.

**Helps in becoming dynamic organisation:** The training modules are superb and the employees always try to find unique ways of providing solutions in the context of rapidly changing business environment.

**Assertion Reason Answer-**

1. c. Assertion is correct statement but reason is wrong statement.
1. a. Assertion and reason both are correct statements and reason is correct explanation for assertion.





# Principles of Management

## 2

### Principle

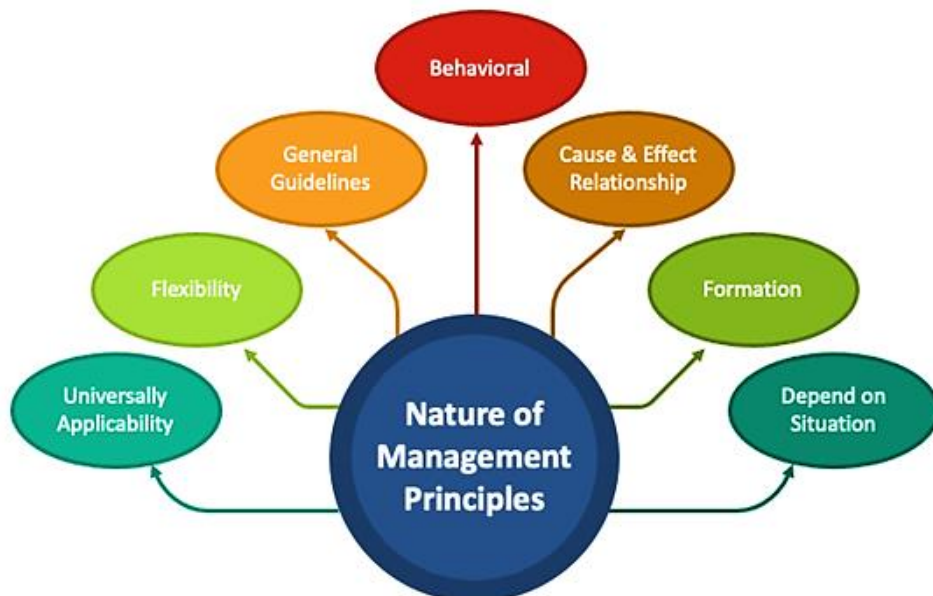
A principle is a statement which provides a guide to thought and action. Principle serves as the foundation for a system of belief or behavior or for a chain of reasoning.

### Principles of Management:

1. Principles of management are broad and fundamental truths that establish relation between cause and their effects.
2. These principles serve as guidelines for managerial decision-making and their course of action.
3. It is through principles that management predicts the result of their actions.
4. Management principles are not as rigid as principles of science as this deals with human behavior and thus are to be applied creatively as the situation demands.



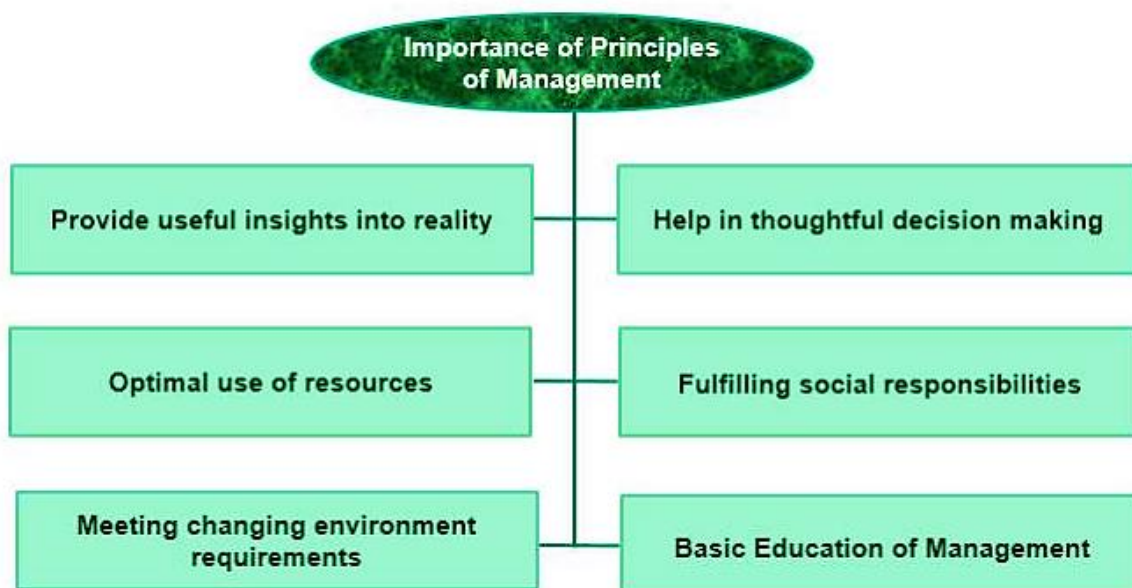
### Nature of Principles of Management:



## The nature of principles of management is given below:

1. **Universality:** Principles of management have universal validity. These are applicable to all types of organizations, business as well as non-business, small as well as large enterprises and at different levels of authority. As these principles are universal, it can be applied in different managerial situations.
2. **Human Behavior:** Management has to deal with human behavior, therefore the principles aim at influencing human behavior. They are general guidelines to action and can be applied according to the situation as they are based on complex human behavior which cannot be controlled.
3. **Created by Practice and Experimentation:** Scientists through research, experiments, knowledge and expertise have developed the principles. The principles are used to solve different managerial problems with the help of observation, analysis and experience.
4. **Dynamic & Flexible:** These principles are not rigid and can be adapted and modified by the practicing managers depending upon the situation and changes in the business environment. They are flexible and dynamic in nature.
5. **Cause and Effect Relationship:** They establish a relationship between cause and effect so that they can be used in different situations.
6. **Contingent:** The principles are relative and not absolute. Depending upon the current situation at a certain point of time, the principles are applied.

## Significance/Importance of the Principles of Management:



The significance of principles of management can be derived from their utility which can be understood from the following points:

1. **Providing managers with useful insights into reality:** Management principles guide managers to take right decision at right time by improving their knowledge, ability and understanding of various managerial situations and circumstances.
2. **Optimum use of resources:** Management principles facilitate optimum use of resources by coordinating the physical, financial and human resources. They also help in better administration by discouraging personal prejudices and adopting an objective approach.
3. **Scientific decisions:** Decisions based on management principles tend to be more realistic, balanced and free from personal bias.



4. **Meeting the changing environmental requirements:** Management principles provide an effective and dynamic leadership and help the organization to implement the changes.
5. **Fulfilling social responsibility:** Principles of management not only help in achieving organizational goals but also guide managers in performing social responsibilities. Example: "Equity" and "Fair" remuneration.
6. **Management training, education and research:** Management principles are helpful in identifying the areas in which existing and future managers should be trained. They also provide the basis for future research.

### Principles of Management Developed by Henry Fayol:

# 14 PRINCIPLES OF MANAGEMENT BY HENRY FAYOL



- 1) Principle of division of work
- 2) Principle of authority and responsibility
- 3) Principle of discipline
- 4) Principle of unity of command
- 5) Unity of direction
- 6) Subordination of individual interest to general interest
- 7) Remuneration of employees
- 8) Centralisation and decentralization
- 9) Scalar chain
- 10) Order
- 11) Equity
- 12) Stability of personal
- 13) Initiative
- 14) Esprit de Corps



### Difference Between Unity of Command and Unity of Direction:

Basis For Comparison	Unity of Command	Unity of Direction
Meaning	As per this principle , an employee should get orders from one superior only and be accountable to him only.	According to this principle, there should be one head and one plan for a group of activities having the same objective.
Purpose	To prevent overlapping of orders and instructions, duplication of work, confusion and indiscipline.	To prevent repetition of activities.
Relation	It relates to the functioning of people.	It relates to activities of the organization.
Outcome	Unity of Command results in effective and efficient functioning of both superior as well as subordinates.	Unity of direction leads to unity of action and coordination of efforts .
Relationship	Unity of command deals with the relationship of superior and subordinate.	Unity of direction deals with the relationship of activities in support of organizational plans and objectives.
Importance	Unity of command helps to fix the responsibility of each person in the organization.	Unity of direction results in efficient functioning of group activities to achieve organizational goals.

### Difference Between principle of Fayol versus Taylor:

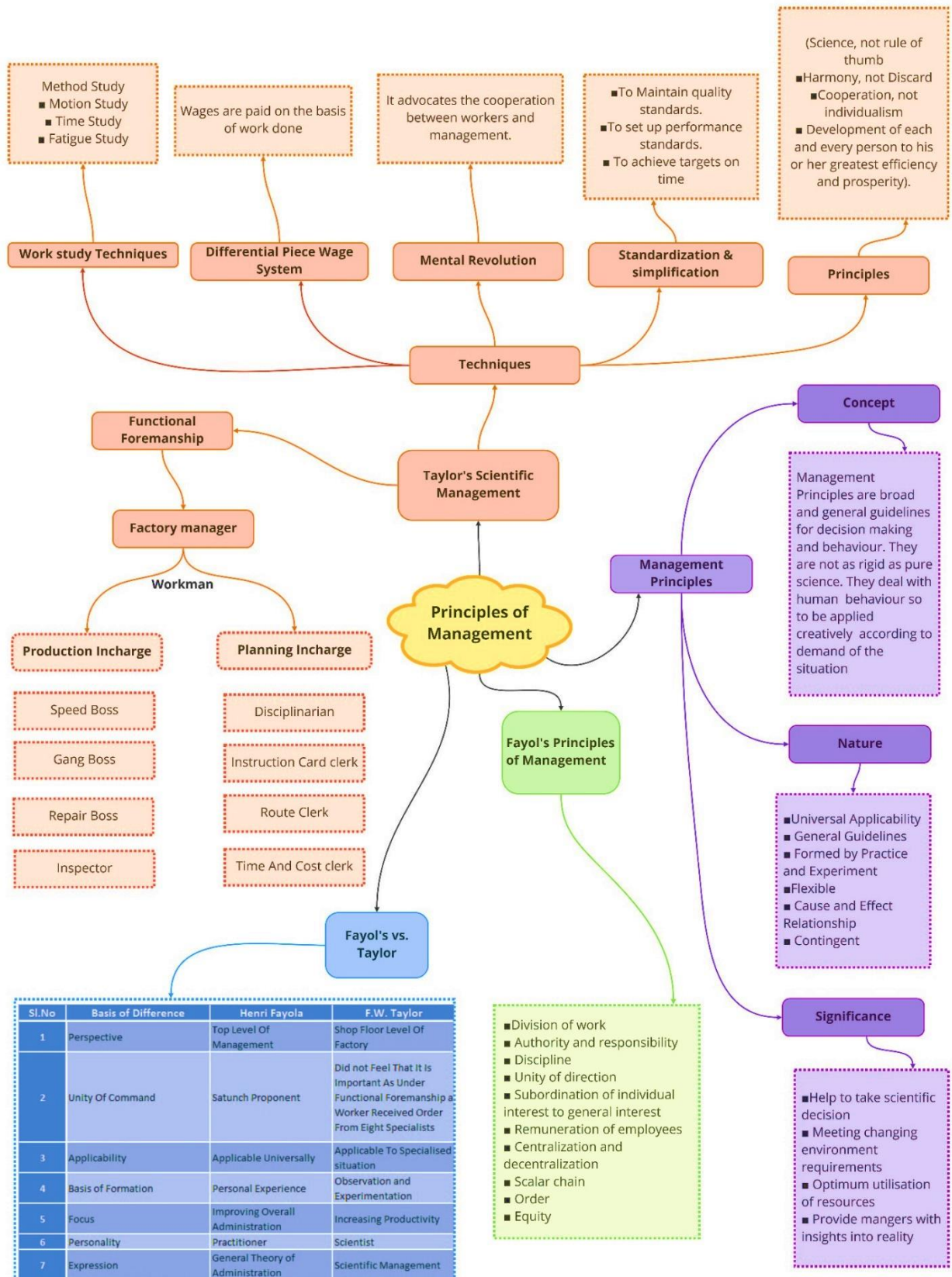
Basis	Henry Fayol	F.W Taylor
Basis of formation	Personal Experience	Observations and experimentation
Focus	Improve overall efficiency of the management.	Increase the productivity of people working in the enterprise.
Applicability	Universal applicability	Applicable only to specialized situations.
Perspective	Top level of management	Operative level of Management
Personality	Practitioner and researcher.	Scientist (known as 'father of scientific management')
Techniques	General theory on management	Scientific Management

### Mental Revolution:

It involves a complete change in mental outlook and attitude of workers and management towards one another from competition to cooperation. The management should create pleasant working conditions & workers should work with devotion and loyalty. Instead of fighting over distribution of profits, they must focus attention on increasing it.



Class : 12th Business Studies  
Chapter-2 : Principles of Management



## Important Questions

### Multiple Choice Questions-

- Which of the following is NOT a Principle of management given by Taylor?
  - Maximum, not restricted output
  - Functional foremanship
  - Harmony not discord
  - Science, not the rule of the Thumb
- Which of the following statement best describes the principle of Division of Work?
  - Labour should be divided
  - Resources should be divided among jobs
  - It leads to specialization
  - Work should be divided into small tasks
- She/he keeps machines, materials, tools, etc., ready for operations by concerned workers? Whose work is described? by this sentence under functional foremanship?
  - Instruction Card Clerk
  - Repair Boss
  - Route Clerk
  - Gang Boss
- How are principles of management formed?
  - By experiences of customers
  - By propagation of social scientists
  - In a laboratory
  - By experiences of managers
- Unity of direction is concerned with \_\_\_\_\_
  - One Head One Plan
  - One Head Different Plans
  - Planning by Production manager
  - Planning by Employees
- Harmony, Not Discord principle is concerned with \_\_\_\_\_
  - Management should share the gains of the company with workers
  - Investigation of Task
  - Scientific inquiry
  - Observation and Analysis
- Henry Fayol was a:
  - Mining Engineer
  - Production engineer
  - Accountant
  - Social Scientist
- The main objective of motion study is \_\_\_\_\_
  - To provide more work to the workers
  - To find out labour cost
  - To eliminate the rest hours of workers
  - To eliminate the unproductive motions
- Principles of management are not:
  - Flexible
  - Behavioural
  - Absolute
  - Universal
- Espirit De Corps means \_\_\_\_\_
  - Union is strength
  - Order
  - Gang Plank
  - Scalar Chain
- Which of the following is not concerned with F.W. Taylor?
  - Motion Study
  - Fatigue Study
  - Method Study
  - Scalar Chain
- In the management process, the most misinterpreted word is
  - Organizing
  - Delegating
  - Controlling
  - Planning
- Who is considered as the father of Scientific Management?
  - Harold Koontz
  - Henry Fayol
  - Gilbreth
  - F.W.Taylor
- Name the organizational structure that assists in increasing managerial and operational efficiency.
  - Functional structure
  - Divisional structure
  - Both a and b
  - None of the above



15. Who said, "Management is a multiple purpose organ that manages a business, manages a manager and manages workers and work"?
- Harold Koontz
  - Peter Drucker
  - Kenneth O'Donnell
  - Anonymous

### Very Short-

- How are management principles derived?
- Give anyone difference between Principle and Technique?
- What is meant by 'Universality of management principles'?

OR

Why is it said that management principles are universal?

- The principles of management aren't rigid and can be modified when the situation demands. Which nature of principles is being discussed here?
- Define scientific management.
- List any two principle of 'Scientific Management' formulated by Taylor for managing an organization scientifically.
- Factory owners or managers relied on personal judgment in attending to the problems they confronted in the course of managing their work. Which principle of Taylor is it referring to?
- What do you mean by Mental Revolution?
- Principle of cooperation, not individualism, is an extension of which principle given by Fayol?
- What is the aim of Method study?

### Short Questions-

- What do you mean by management principles?
- How are management principles derived?

OR

"Management principles are evolutionary." Explain.

OR

"Derivation of management principles may be said to be a matter of science." Explain.

- Give three points reflecting the nature of management principles.
- "Principles of management achieve results economically." Explain?
- Define scientific management and name any three of its principles.

- Explain the objectives of standardization.
- Which technique of Taylor suggests that each worker should be supervised by specialists? Give the designations of any four specialists suggested by him.
- 'Discipline is double-edged tool' Comment.
- Explain the principle of unity of direction.
- An organization follows the principles of management. What are the adverse effects of each of the following principles of management on the organization?
  - Unity of Command
  - Order
  - Stability of tenure of personnel

### Long Questions-

- Explain the nature of management principles.
- Explain the importance of management principles.
- Taylor's principles of scientific management and Fayol's principles of management are mutually complementary." Do you agree with this view? Give any four reasons in support of your answer.
- Name the main principles of Management propounded by Henry Fayol and explain any two?
- Give reasons for or against the Universality of the principle of Management?

### Case Study Based Question-

- Sanchit, after completing his entrepreneurship course from Sweden returned to India and started a coffee shop 'Aroma Coffee Can' in a famous mall in New Delhi. The specialty of the coffee shop was the special aroma of coffee and a wide variety of flavours to choose from. Somehow, the business was neither profitable nor popular. Sanchit was keen to find out the reason. He appointed Sandhya, an MBA from a reputed college, as a Manager to find out the causes for the same.

Sandhya took feedback from the clients and found out that though they loved the special unique aroma of coffee but were not happy with the long waiting time being taken to process the order. She analysed and found out that there were many unnecessary obstructions in between which could be eliminated. She fixed a standard time for processing the order.

She also realised that there were some flavours whose demand was not enough. So, she also decided to stop the sale of such flavours. As a

result with in a short period Sandhya was able to attract the customers.

Identify and explain any two techniques of scientific management used by Sandhya to solve the problem. (CBSE, Delhi 2017)

2. Nutan Tiffin Box service was started in Mumbai by the Mumbai Dabbawalas. The Dabbawalas who are the soul of entire Mumbai aim to provide prompt and efficient services by providing tasty homemade tiffin to all office goers at the right time and place. The service is uninterrupted even on the days of bad weather, political unrest and social disturbances. Recently, they have started online booking system through their website 'mydabbawala.com'. Owing to their tremendous popularity amongst the happy and satisfied customers and members, the Dabbawalas were invited as guest lecturer by top business schools. The Dabbawalas operate in a group of 25-30 people alongwith a group leader. Each group teams up with other groups in order to deliver the tiffins on time. They are not transferred on frequent basis as they have to remember the addresses of their customers. They follow certain rules while doing trade—no alcohol during working hours; no leaves without permission; wearing white caps and carrying ID cards during business hours.

Recently, on the suggestion of a few self-motivated fellow men, the dabbawalas thought out and executed a plan of providing food left in tiffins by customers to slum children. They have instructed their customers to place red sticker if food is left in the tiffin, to be fed to poor children later.

- State any one principle of management given by Fayol and one characteristic of management mentioned in the above case.
- Give any two values which the Dabbawalas want to communicated to society. (CBSE, Sample Paper 2016)

### Assertion Reason Question-

- In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.
  - Assertion and reason both are correct statements and reason is correct explanation for assertion.
  - Assertion and reason both are correct statements but reason is not correct explanation for assertion.
  - Assertion is correct statement but reason is wrong statement.
  - Assertion is wrong statement but reason is correct statement.

**Assertion (A):** Management Principles can not be used as tailor-made tools and have to be adjusted as per the demand of the situation.

**Reason (R):** Real Business situations are very complex and dynamic.

- In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.
  - Assertion and reason both are correct statements and reason is correct explanation for assertion.
  - Assertion and reason both are correct statements but reason is not correct explanation for assertion.
  - Assertion is correct statement but reason is wrong statement.
  - Assertion is wrong statement but reason is correct statement.

**Assertion (A):** Motion study helps to improve the efficiency of the workers.

**Reason (R):** It eliminates wasteful and inefficient motions by workers and machines to identify the best method of work.

## Answer Key

### MCQ Answers-

- Answer:** (b) Functional foremanship
- Answer:** (d) Work should be divided into small tasks
- Answer:** (d) Gang Boss

- Answer:** (d) By experiences of managers
- Answer:** (a) One Head One Plan
- Answer:** (a) Management should share the gains of the company with workers
- Answer:** (a) Mining Engineer



8. **Answer:** (d) To eliminate the unproductive motions
9. **Answer:** (c) Absolute
10. **Answer:** (a) Union is strength
11. **Answer:** (d) Scalar Chain
12. **Answer:** (a) Organizing
13. **Answer:** (d) F.W.Taylor
14. **Answer:** (a) Functional structure
15. **Answer:** (b) Peter Drucker

### Very Short Answers-

1. **Ans.** Management principles are derived through observation and analysis of events.
2. **Ans.** Principles are guidelines to take decision whereas techniques are methods to take action.
3. **Ans.** This it means that they are applicable to all kinds of organizations.
4. **Ans.** Flexibility.
5. **Ans.** Application of a scientific approach to managerial decision making.
6. **Ans.** (i) Science, not Rule of Thumb. (ii) Harmony, not Discord.
7. **Ans.** 'Rule of thumb'
8. **Ans.** Mental Revolution means revolutionary change in the attitude of both workers and managers from competition to cooperation.
9. **Ans.** Principle of Harmony, not discord.
10. **Ans.** Aim is to find one best method of doing the job.

### Short Answers -

1. **Ans.** Principles are statements of fundamental truths about some phenomena and serve as a guide for thoughts and actions. They establish cause and effect relationship. Management Principles are the fundamental statements of truth that provide guidelines to the managers for decision making and actions. These enable the managers to manage the enterprises in "3E way" viz 'economically', 'effectively' and 'efficiently'. These act as guide for managers and sharpen their skills and competence. For example, principle of division of labor increases the efficiency of workers which ultimately leads to economy and effectiveness in the organization.
2. **Ans.** Management principles are not made in heavens; they have emerged gradually, through an evolutionary process of combining deep observations and experimental studies.

### (i) Observation method

Under this method, practical events are observed and analyzed by managerial researchers to derive management principles. For example, it was observed that by dividing the work into different units, efficiency of employees improved. As a result, it led to formulation of principle of 'division of labor'.

### (ii) Experimental method

Under this method, experiments are conducted so that management principles can be derived and their validity can be tested. For example, two units, one unit involving one superior and one subordinate and other unit involving two superiors and one subordinate, were taken. It was found that unit having one superior and one subordinate performed better. As a result, it led to formation of principle of "unity of command." From the above it can be concluded that observations and experiments result in the formulation of management principles which therefore are evolutionary. Hence, derivation of management principles can be said to be a matter of Science. It is worth mentioning here that even though derivation of management principles is a matter of science; their application remains a matter of art. The success of managers depends upon how skillfully they put these principles into practice.

3. **Ans.** Management principles are (any three):
  - (i) Universal in application.
  - (ii) General guidelines.
  - (iii) Flexible and can be applied differently under different conditions.
  - (iv) Formed by practice and experimentation.
  - (v) Establish cause and effect relationships.
4. **Ans.** Management principles help in setting realistic objectives for the business because the objectives are set with the participation of employees. Hence, the employees work to their full potential and their commitment level increases because objectives of organization become their own objectives. For example, the principle of maximum output rather than restricted one ensures more output. More output lowers cost per unit and hence profit per unit increases.

5. **Ans.** According to Taylor, "Scientific management means knowing exactly what you want your men to do and seeing that they do it in the best and cheapest way". Three principles of scientific management are as follows:
- Science, not rule of thumb
  - Harmony, not discord.
  - Cooperation, not individualism.
6. **Ans.** Standardization is done for the following reasons:
- To ensure that a given product range has fixed types, sizes, characteristics etc.
  - To bring about interchangeability, for manufactured parts, output, developments etc. among various branches.
  - To set uniform standards of performance for men, machines etc.
7. **Ans.** The technique of functional foremanship suggests that each worker should be supervised by specialists. These specialists' designations are follow.
- Instruction Card Clerk
  - Route Clerk
  - Time and Cost Clerk
  - Disciplinarian
8. **Ans.** Discipline is a double-edged tool. It is expected to strike a balance between enforcing the discipline on one hand and motivating employees on the other. Personnel entrusted with enforcing it are expected to be competent and capable of achieving this balance. Employees must honor the commitment made by them and management must meet its promises to increase wages declaration of bonus etc. To achieve proper discipline, skilled superiors at all levels, clear and fair agreements and judicious application of penalties etc. are required.
9. **Ans.** This principle suggests that in an organization there should be one head and one plan for a group of activities having the same objective. This helps in bringing unity of action and coordination in an organization. If a company is manufacturing two different products then it should have two separate divisions or departments for both the products. Each division or department should have their separate in-charge, plans and execution resources etc.
10. **Ans. Adverse effects of said principles are:**
- Unity of Command:** If this principle is followed, work gets delayed which results in wastage of time and cost.
  - Order:** It creates boredom among the employees due to rigidity provided by this principle.
  - Stability of personnel:** If employees are not rotated on different jobs frequently, they can specialize only in a small part of the whole process of production and thus can never become versatile.

### Long Answers -

1. **Ans.** Nature of management principles can be described as follows:
- Universal Applicability:** The principles of management are applicable to all types of organizations irrespective of their size and nature.
  - General Guidelines:** They are only guidelines for action and don't provide direct or readymade solution for a managerial problem.
  - Formed by practice and experimentation:** The principles of management have been developed through experimentation as well as experience and wisdom of managers.
  - Flexible:** They are flexible i.e. they can be modified by the managers according to a given situation.
  - Mainly behavioral:** They are mainly behavioral in nature since they are devised to influence human behavior.
  - Cause and effect relationship:** The principles of management establish relationship between cause and effect. They guide us as to what would be the effect if a particular principle were to be applied in a given situation.
  - Contingent:** The use of principles of management is contingent or dependent upon the prevailing conditions.
2. **Ans.** The importance of management principles can be understood by considering the following points:
- Provide useful insight to manage:** Principles of management help in increasing managerial efficiency by adding to their knowledge and ability to understand the various situations more objectively.



(ii) **Optimum Utilization of Resources and effective administration:**

Management principles help in organizing various activities in such a way that results in elimination of unwanted activities and consequent wastage. Management principles help in managing organizations effectively. For example, Unity of Command helps to avoid confusion and conflicts. Unity of Direction ensures unity of actions to facilitate coordination.

(iii) **Scientific decisions:** They help the managers in taking the decisions based on the objective assessment of a situation. Thus decisions taken are logical and free from any bias and prejudice.

(iv) **Meeting changing environment requirements:** Though the principles are only guidelines for action yet they can be modified according to the need of changing situations. Thus principles of management help in meeting changing requirements of the environment.

(v) **Fulfilling social responsibilities:** Principles of management have been devised in such a way that they help in fulfilling social responsibilities.

(vi) **Management training, education and research:** Principles of management are the fulcrum of management theory so that they are used as a basis for management training, education and research.

3. **Ans.** Yes, Taylor's principles of scientific management and Fayol's principles of management are mutually complementary because of the following reasons:

Basis	Taylor	Fayol
1. Personality	Taylor was a scientist	Fayol was a practitioner
2. Perspective	Taylor's principles & techniques are based on bottom upward approach	Fayol's principles are based on top downward approach

3. Scope and Applicability	Taylor's principles & techniques are relevant mainly with respect to production activities	Fayol's principles have wider relevance in all functional areas
4. Focus	Taylor's principles & techniques are focused on workers' efficiency and production.	Fayol's principles are focused on improving overall management efficiency.
5. Modifications	Taylor's techniques are more specific in nature and should be applied without any modification and only in specific conditions	Fayol's principles are more general in nature & can be applied in most of the organizations with some modifications.
6. Expression	Taylor expressed his thoughts and views under the theory of scientific management	Fayol expressed his ideas as the general theory of management.

4. **Ans.**

**Development of Management Principles:** It was Henry Fayol a French mining engineer and chief executive who for the first time stated a set of 14 principles of management. Fayol wrote these principles on the basis of his practical experience as a manager. According to him, these principles can be applied in all types, functions, levels, and sizes of organizations. This had earned him the title 'universalist'. For a long time, Fayol's list was accepted as 'Complete and Comprehensive'. A description of these principles follows.

1. Division of Work
2. Authority and Responsibility
3. Discipline
4. Unity of command



5. Unity of direction
6. Subordination of individual interests to the general interests
7. Remuneration
8. Centralization
9. Scalar chain hierarchy
10. Order
11. Equity
12. Stability of personnel
13. Initiative
14. Esprit de corps

1. **Division of Work** – This is the principle of specialization which applies to all kinds of work. The more people specialize, the more efficiently they can perform their work. Specialization increases output by making employees more efficient.
2. **Authority and Responsibility** – Authority is the right to give orders and the power to exact obedience. Managers need authority to get things done. According to Fayol, responsibility is a corollary and a natural consequence of authority. Responsibilities an obligation to perform the tasks in a satisfactory manner.

5. **Ans.**

University of Management principles Universality of management suggests that the manager uses the same managerial skills and principles in each managerial position held in various organizations. Accordingly, an industrial manager could manage a philanthropic organization, a retired army general could manage a university, a civil servant could manage an industrial organization, and so on.

Universality implies transferability of Managerial skills across industries, countries, countries. It means that management is generic in content and applicable to all types of organizations. Lawrence A. Appley declared that 'He who can manage, can manage anything.' Let us examine the factors that have contributed to the universal application of management in every level of organization and at every level of organizations.

**Arguments for Universality:**

1. Managers perform the same functions irrespective of their level in the organization, industry, or country. The functions

performed by the company president and the office supervisors .are the same Regardless of the label-all managers plan, organize, lead and control. The difference lies in such things as the breadth of the objectives, the magnitude of the decision taken, the organization's relationships affected, and so on.

2. Classical writers like Fayol, Urwick, and others believed that there are certain principles in management that are universally applicable.
3. The fundamentals governing the management of a business, a Church, or a university are the same, the differences lie in the techniques employed and practices followed. All managers accountable for the performance of other people, they plan, make decisions, organize work, motivate people and implements control, and so forth. In order to achieve the results the techniques employed might differ depending on situational factors like culture, tradition, attitudes, etc.
4. The very fact that managers regularly move from public to private sector organizations bears ample testimony to the fact that management concepts are universal across organizational types.

Arguments against the Universality This is –

1. The universal thesis implies complete substitutability of managerial skills which is rarely found in actual practice. It seems improbable that the captain of a hockey team would excel equally as the president of the charitable agency or as the vice-chancellor of a university. It is true that the manager's job becomes almost universal in content at the upper levels of organizations. At a lower level of organization, however, transferability of managerial skills may not be possible.
2. Universality thesis presupposes the existence of predictability regarding the outcomes of management actions. A manager working in firm A must be able to predict the likely consequences of his actions in firm B where he is likely to join. And he may have to face serious problems in case the underlying philosophies of these organizations were to differ.



## Case Study Answer-

### 1. Answer:

The two techniques of scientific management used by Sandhya to solve the problem are: (any two)

**Time study:** It seeks to determine the standard time taken to perform a well-defined job. The objective of time study is to determine the number of workers to be employed, frame suitable incentive schemes and determine labour costs. By using time measuring devices for each element of task the standard time is fixed for the whole of the task by taking several readings.

**Simplification (Standardisation and Simplification):** Simplification aims at eliminating superfluous diversity of products in terms of varieties, sizes and dimensions. It not only helps to reduce inventories but also save cost of labour, machines and tools. Thus it helps to increase turnover by ensuring optimum utilisation of resources.

**Motion study:** Motion study refers to the study of movements of limbs of a worker while doing a particular task. It seek to divide all such movements into three categories namely;

- Motions which are required
- Motions which are unnecessary
- Motions which are incidental.

Thus, motion study helps to eliminate unnecessary movements of a work and enables him to complete the given task efficiently.

### 2. Answer:

The relevant principle of management given by Fayol is: Stability of Personnel: The employee turnover should be minimized to maintain organizational efficiency. Personnel should be selected and appointed after due and rigorous procedure. After placement, they should be kept at their post for a minimum fixed tenure so that they get time to show results. Any adhocism in this regard will create instability/insecurity among employees. They would tend to leave the organisation. (The other correct answers are principle of Discipline / Initiative / Espirit de corps) The characteristic of management mentioned in the above case is: Management is goal oriented as it seeks to integrate the efforts of different individuals towards the accomplishment of both organizational and individual goals.

(The other correct answers are management is intangible/ group activity/dynamic)

**The two values that Dabbawalas want to communicate to society are:**

- Concern for poor/ Humanity
- Responsibility

## Assertion Reason Answer-

1. a. Assertion and reason both are correct statements and reason is correct explanation for assertion.
2. a. Assertion and reason both are correct statements and reason is correct explanation for assertion.



# Business Environment

# 3

## Meaning of Business Environment

Business environment refers to all the factors that are outside the control of the business enterprise but may equally affect the performance of the business. The social, political, economic, technological factors that operate outside a business forms a part of the business environment.



## Features of Business Environment:

1. **Totality of external forces:** Includes every external or outside force that could impact a business organisation such as government, competitors, etc.
2. **Specific and general forces:** Specific forces are the forces which directly affect a specific business organisation. General forces are those forces which pose a direct impact on the overall industry, but pose an indirect effect on a business enterprise.
3. **Inter-relatedness:** The changes in general forces may result in changes in specific forces. For example, a change in the government (a political force) may lead to a change in tax rates, import-export rates (an economic force)
4. **Dynamic nature:** The external forces keep changing due to constant change in technology, consumer preferences, availability of different types of raw material etc.
5. **Uncertainty:** Constant changes in environment makes it difficult to predict changes in the external environment.
6. **Complexity:** The interrelated and dynamic nature of external forces makes it difficult to prepare one single strategy to handle all the changes.
7. **Relativity:** The impact of changes depends on business to business country to country region to region etc.

## Importance of Business Environment:

1. Environment Provides Numerous Opportunities for Business Success It enables the firm to identify opportunities and getting the first mover advantage.
2. Threats and Early Warning Signals Environmental awareness can help managers to identify various threats on time and serve as an early warning signal.



3. It Helps in Tapping Useful Resources Environment is a source of various resources for running a business. Like as finance, machines, raw materials etc.
4. It Helps in Copying with Rapid Changes Knowledge of environmental changes sensitises the management to make new strategy to copy with the emerging problems of changes.
5. It Helps in Assisting in Planning and Policy Formulation Its understanding and analysis can be the basis for deciding the future course of action or training guidelines for decision making.
6. It helps in Improving Performance With continuous scan of business environment, companies can easily improve their performance.

### Dimensions in Business Environment:

1. **Economic Environment:** It refers to all those factors and forces that have an economic impact on the business activities. Key economic factors include inflation, money supply, price level, etc. For example, increase in inflation rates result in fall in disposable incomes and as a result the demand for products falls.
2. **Social Environment:** Social environment represents the customs and traditions, values, culture, social trends, beliefs, ethics of society in which business operate. For example, with greater awareness among consumers about their rights, businesses are more concerned about the quality of goods they sell.
3. **Political Environment:** It includes political stability such as political leadership, political stability, practices of the ruling party, etc. For example, change in government, or unstable government.
4. **Legal Environment:** It includes all the legislations passed, administrative orders issued, court judgements or decisions taken by government or its related offices. For example, all cigarette packets must carry a warning 'smoking is injurious to health'.
5. **Technological Environment:** It consists of forces relating to scientific improvements and innovations, which lead to better production techniques and methods to produce goods. For example, shift from books to e-books, telephones to touch screen mobile phones.
6. After demonetisation, cash is deposited into banks for exchanging with new notes which makes the payment of tax compulsory with penalty rate.
7. Government introduced demonetisation to reduce tax evasion.
8. Demonetisation reduces the cash transactions in the economy which means more savings through the financial system and improving tax payment system.
9. Demonetisation facilitates tax administration, and pave way for a cashless economy



### Economic Environment in India:

Since 1991 India has been going on economic reforms. We have now adopted the policy of liberalisation, privatisation and globalisation, We have started modernising the country's industrial system. Unproductive control are being removed private investment, including foreign investment is being encouraged.

1. **Liberalisation:** It means removing unnecessary trade restrictions and making the economy more competitive like as freedom of production, expansion of industries.
2. **Privatisation:** It means removing strict control over private sector and making them free to take necessary decisions. Like as reduction in the number of reserved public sector industries, increasing the share of private sector investment.

3. **Globalisation:** Free interaction among economies of the world in the field of trade, finance, production, technologies and investment is termed as globalisation. Our new economic policy contributed towards globalisation in the following ways.
4. **Privatisation:** It refers to the shifting of the development responsibility from the public sector towards the private sector. Private sector are those where the share of government in the ownership of the enterprise is less than 51 percent.

**Impact of Demonetisation:**

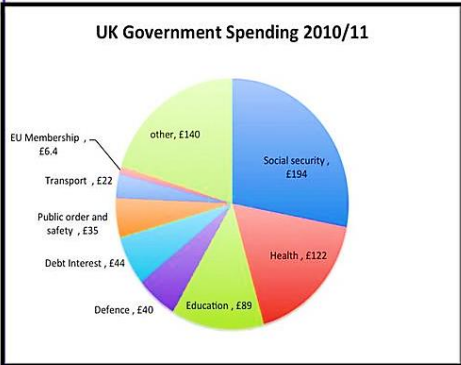
<b>Money/Interest rates</b>	Decrease in transactions of cash. Increase in bank deposits. Financial savings increased.
<b>Private wealth</b>	High demonetised notes were not returned and real estate prices also fell which lead to decrease in private wealth.
<b>Public sector wealth</b>	There was no effect.
<b>Digitalisation</b>	Increase in the digital transactions (like Rupay, AEPS) among new users.
<b>Real estate</b>	Decrease in the prices.
<b>Tax collection</b>	Due to higher disclosure there was rise in tax collection.

**Impact of Government Policy Changes on Business and Industry:**

1. **Increasing Competition:** There is a tough competition between multinationals and there is also competitions between Indian enterprises and foreign enterprises.
2. **More Demanding Customers:** Customers today become more demanding because they are well-informed.
3. **World Class Technology:** Changes in government policy regarding business and industry has provided us with world class technology.
4. **Necessity for Change:** After 1991, the market forces have become turbulent as a result of which the enterprises have to continuously modify their operations.
5. **Need for Developing Human Resource:** The new market conditions requires people with higher competence and greater commitment.
6. **Market Orientation:** Today firms are market oriented. They research the market, need and wants of consumers and then they produce good accordingly.
7. **Loss of Budgetary:** Support to Public Sectors The government’s budgetary support for financing the public sector has declined over the years.

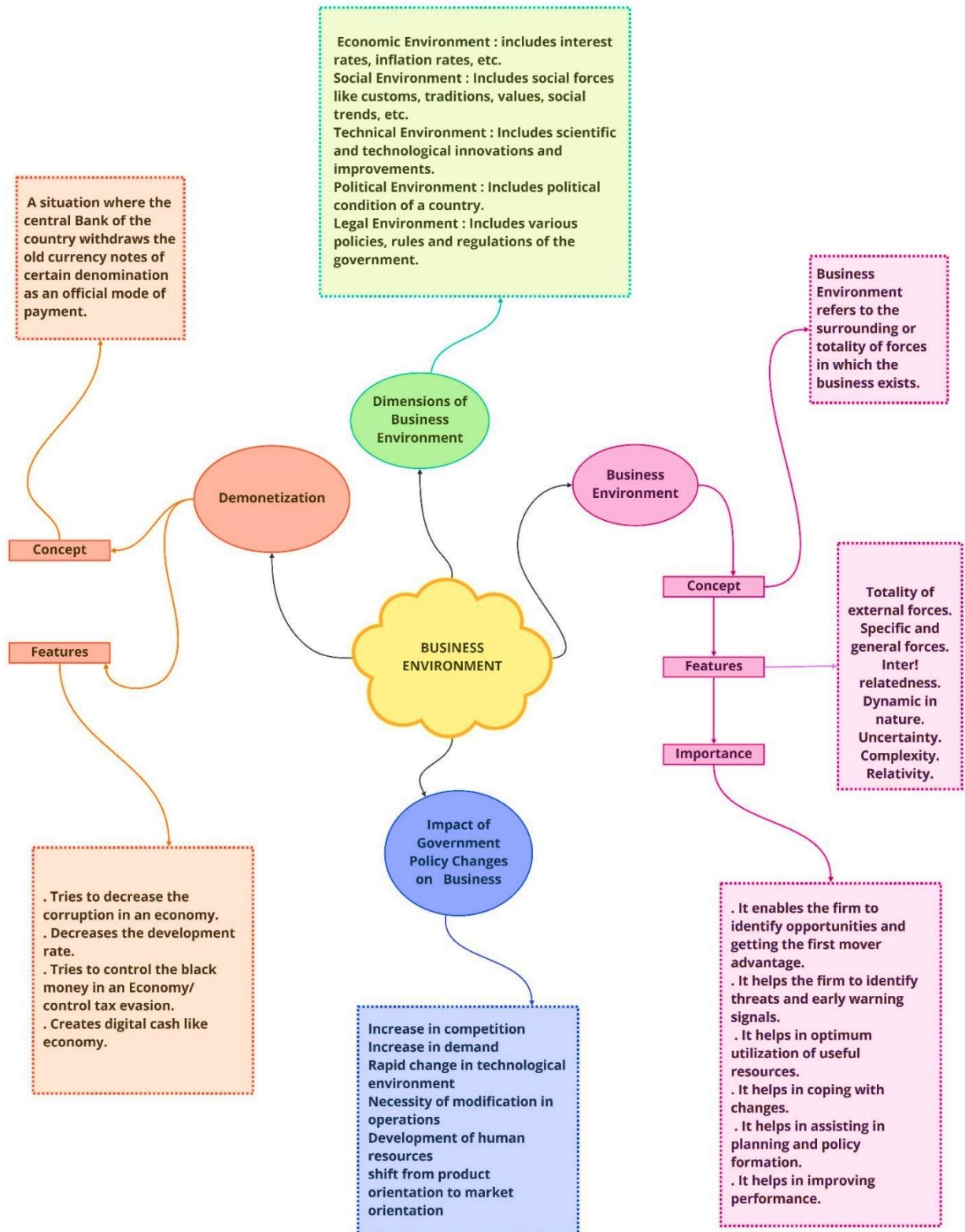
**Government spending and taxation**

- The government can change the way businesses work and influence the economy either by passing laws, or by changing its own spending or taxes. For example:
- Extra **government spending** or lower **taxes** can result in more demand in the economy and lead to higher output and employment.
- Governments can pass **legislation** protecting consumers and workers or restricting where businesses can build new premises.





Class : 12th Business Studies  
Chapter-3 : Business Environment



## Important Questions

### Multiple Choice Questions-

- Relaxing the restrictions and controls imposed on Business and industry means
  - Liberalisation
  - Privatisation
  - Globalisation
  - None of the above
- Which of the following best indicates the importance of the business environment?
  - Coping with rapid changes
  - Identification
  - Improvement in performance
  - All of the above
- What will be the effect of an increase in tax by the government?
  - Increase in cost of production
  - Creates fear in the minds of investors
  - Increase in profit margin
  - None of the above
- What creates fear in the minds of investors to invest in long term projects?
  - Privatisation
  - Political Uncertainty
  - Liberalisation
  - None of the above
- Which of the following creates fear in the minds of investors?
  - Political uncertainty
  - New innovations
  - None of these
  - Technological improvements
- Celebration of Diwali is the example of:
  - Technological Environment
  - Social Environment
  - Political Environment
  - Legal Environment
- Booking of Railway tickets through internet from home or office is an example of \_\_\_\_\_
  - Political Environment
  - Technological Environment
  - Economic Environment
  - None of the above
- Export promotion is concerned with \_\_\_\_\_
  - Privatisation
  - Globalisation
  - Liberalisation
  - None of the above
- Changes in fashions and tastes of consumers will \_\_\_\_\_
  - Shift the market demand from an existing product to new ones
  - Increase the cost of production
  - Increase the profit
  - Increase the Sale
- Increased competition in the market will \_\_\_\_\_
  - Increase the tax
  - Increase the profit
  - Increase the cost of production
  - Reduce the profit margin
- Giving freedom to Indian business and industries from all unnecessary government controls and restrictions is an example of \_\_\_\_\_
  - Privatisation
  - Globalisation
  - Liberalisation
  - None of the above
- Technological improvements and innovations result in \_\_\_\_\_
  - Increase in tax
  - Render existing products obsolete
  - Reduction in profit margins
  - None of the above
- Which of the following does not explain the impact of Government policy changes on business and industry?
  - More demanding customers
  - Change in agricultural prices
  - Increasing competition
  - Market orientation
- Globalisation aims at \_\_\_\_\_
  - Export Promotion
  - Foreign exchange reforms
  - Import liberalization
  - All of the above



15. When a company taken over another one and clearly becomes the new owner, the action is called
- Merger
  - Acquisition
  - Strategic Alliance
  - None of the above

### Very Short-

- What is Business Environment?
- How have customers benefited by increased competition after liberalization and globalization?
- How can the firms cope up with changing technological environment?
- What do you mean by Globalization?
- Which policy of Indian Government has moved India towards globalization?
- What do you mean by disinvestment?
- Give one measure taken by Indian Government to introduce liberalization.
- What do you mean by first mover advantage?
- What are Values?
- Which of the sector was given importance after independence?

### Short Questions-

- Define Business Environment. State two important concerns of business environment.
- Explain the specific and general forces of business environment ?
- Enumerate the benefits of understanding business environment?
- What are the main dimensions of business environment?
- Explain the role of political environment in shaping the business?
- Explain the concept of technological environment?
- What do you understand by legal environment? Give two examples which protect consumers' interests.
- List the various changes initiated by the Government of India since 1991.
- List some important factors that influence the working of a business enterprises?
- Give your views on 'Economic Environment in India.

### Long Questions-

- What do you mean by business environment? Explain the key components of business environment.
- What do you understand by economic environment? List the main aspects of economic environment.
- Social environment of business is important for a business enterprise". Explain ?
- Enumerate negative impacts of liberalization and globalization.
- Enumerate any ten Positive impacts of liberalization and globalization.
- Explain any five negative impacts of liberalization and globalization.

### Case Study Based Question-

- Metlapp Networks and Technologies Ltd. is a leader in technology innovation in the United States, creating products and solutions for connecting the world. It has, a large research and development team which invented the first smart watch, named as W-7. The watch besides showing the time, also monitors few health parameters like heartbeat, blood pressure etc.

While in search of markets abroad, the company found that in India, the reform process was underway with the aim of accelerating the pace of economic growth. The company decided to take advantage of simplified export procedure and removal of quantitative as well as tariff restrictions in India. It set up its office in Jamnagar with a view to capture the Indian market. In a short span of time, the company emerged as a market leader. Success of the company attracted many other players to enter the market. Competition resulted in reduction in prices, thereby benefiting the customers.

- In the above paragraph, two major concepts related to government policy have been discussed. Identify and explain these concepts.
  - Also, explain briefly any three impacts of these concepts on Indian business and industry.
- Naman and Govind after finishing their graduation under vocational stream decided to start their own travel agency which will book Rail Tickets and Air Tickets on commission basis. They also



thought of providing tickets within ten minutes through the use of internet. They discussed the idea with their Professor Mr. Mehta who liked the idea and suggested them to first analyse the business environment which consists of investors', competitors and other forces like social, political etc. that may affect their business directly or indirectly. He further told them about the technological improvements and shifts in consumer preferences that were taking place and hence they should be aware of the environmental trends and changes which may hinder their business performance. He emphasised on making plans keeping in mind the threat posed by the competitors, so that they can deal with the situation effectively. This alignment of business operations with the business environment will result in better performance.

- Identify and state the component of business environment highlighted in the above Para.
- State any two features of business environment as discussed by Professor Mehta with Naman and Govind.
- Also state two points of importance of business environment as stated by Professor Mehta in the above situation.

### Assertion Reason Type Question-

- In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.
  - Assertion and reason both are correct statements and reason is correct explanation

for assertion.

- Assertion and reason both are correct statements but reason is not correct explanation for assertion.
  - Assertion is correct statement but reason is wrong statement.
  - Assertion is wrong statement but reason is correct statement.
- In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.
    - Assertion and reason both are correct statements and reason is correct explanation for assertion.
    - Assertion and reason both are correct statements but reason is not correct explanation for assertion.
    - Assertion is correct statement but reason is wrong statement.
    - Assertion is wrong statement but reason is correct statement.

**Assertion:** The business environment helps in understanding the threats which are likely to happen in the future.

**Reason:** Environmental awareness can help managers to identify various threats on time and serve as an early warning signal.

## Answer Key

### MCQ Answers-

- Answer:** (a) Liberalisation
- Answer:** (d) All of the above
- Answer:** (a) Increase in cost of production
- Answer:** (b) Political Uncertainty
- Answer:** (a) Political uncertainty
- Answer:** (b) Social Environment
- Answer:** (b) Technological Environment
- Answer:** (b) Globalisation
- Answer:** (a) Shift the market demand from an existing product to new ones

- Answer:** (d) Reduce the profit margin
- Answer:** (c) Liberalisation
- Answer:** (b) Render existing products obsolete
- Answer:** (b) Change in agricultural prices
- Answer:** (d) All of the above
- Answer:** (b) Acquisition

### Very Short Answers-

- Ans.** Forces affecting the performance of an organization but outside its control are called as Business Environment.



2. **Ans.** While purchasing they get a better quality and wider choice of goods and services.
3. **Ans.** They have to develop new ways.
4. **Ans.** When the various economies of the world integrate, it is known as Globalization.
5. **Ans.** The Industrial Policy of 1991.
6. **Ans.** When the private sector takes over public sector, it is called disinvestment.
7. **Ans.** Abolishing licensing requirements.
8. **Ans.** Early identification of opportunities.
9. **Ans.** Concepts held by a society in high esteem are values.
10. **Ans.** Public Sector.

### Short Answers-

1. **Ans.** The sum total of all external factors which are outside the control of business enterprises is termed as Business Environment. Factors may be social, political, economic etc.
  2. **Ans.** Business environment comprises of both specific and general forces. Specific forces refer to those forces that are having direct effect on the day to day working of the business viz. customers, competitors, investors etc. General forces refer to social, political, legal and other forces which are having an indirect effect on the operations of a business.
  3. **Ans.** The benefits of understanding business environment are:
    - (i) Enabling the identification of opportunities and getting the first mover advantage.
    - (ii) Helping in the identification of threats and early
    - (iii) Tapping useful resources.
    - (iv) Coping with the rapid changes.
    - (v) Assisting in planning and policy.
    - (vi) Improvement in performance.
  4. **Ans.** The main dimensions of business environment are:
    - (i) Economic, (ii) Social, (iii) Technological, (iv) Political, (v) Legal
 Economic environment consists of the factors having economic dimensions such as fiscal policy, monetary policy, industrial policy etc.
  5. **Ans.** Business functions within the framework of political environment. Generally, government's policies change with the change of guard in power. Business is required to understand and follow such changes and also respect the orders that judiciary gives from time to time.
- For example, after globalization, Government of India allowed many companies to enter the Indian market for giving boost to the different industries like food processing industry etc. That paved the way for entry of multinationals in India on a large scale.
6. **Ans.** It includes new approaches, new procedures, and new equipment's to transform inputs into outputs. It facilitates an organization's efficiency and effectiveness so that it can try to remain at par with the best in the world. Technological changes provide opportunities for some enterprises and become threats for some others.
 

For example, digital watches killed the business prospects of traditional watches; TV has adversely affected radio & cinema industry; mobile phones have taken over the market from landline phones.
  7. **Ans.** Legal environment consists of rules and regulations, framed by the Parliament, under which business must operate. To exist and grow, business is required to follow all the rules and regulations that constitute this environment.
 

Two examples protecting consumers' interests:

    - (i) Advertisement of alcoholic beverages is prohibited.
    - (ii) Packets of cigarettes should mention the statutory warning 'Cigarette smoking is Injurious to health'.
  8. **Ans.** Various changes initiated by the Government of India since 1991 are as follows:
    - (i) New industrial policy
    - (ii) New trade policy
    - (iii) Fiscal reforms
    - (iv) Monetary policy
    - (v) Capital market reforms
    - (vi) Phasing out of Subsidies and Price controls
  9. **Ans.** Following are the important factors that influence the working of a business enterprise:-
    - (i) Changes in economic policies.
    - (ii) Political uncertainty in the country.
    - (iii) Increase in the rate of competition.
    - (iv) Changes in fashion.
  10. **Ans.** The economic environment in India consists of various macro-level factors related to the means of production and distribution of wealth which have an impact on business. These are:
    1. Stage of economic development of the country.

2. The economic structure in the form of a mixed economy.
3. Economic policies of Government including industrial monetary and fiscal policy.
4. Economic planning including five-year plans etc.
5. Infrastructural factors such as financial institutions.

### Long Answers-

1. **Ans.** Business environment is the sum total of all external factors that influence the functioning of a business enterprise. The components of general environment are:

#### (i) Economic environment:

Economic environment consists of factors having economic dimensions such as fiscal policy, monetary policy, industrial policy etc.

**Impact:** Banking sector reforms have led to attractive deposit avenues and easier credit policy. Likewise reforms in leasing & financial institutions are also catalyzing company's economic growth.

#### (ii) Social environment:

It discriminates characteristics of the society in which an enterprise exists. It consists of literary rates, educational levels, customs and demographic distribution etc.

**Impact:** Equal pay for equal work for both male and female workers, reservation of jobs for minorities etc.

#### (iii) Political environment

It consists of the political forces responsible for the management of public affairs and their influence on business.

**Impact:** Government allowed Pepsi to enter Indian market again for giving boost to the food processing industry.

#### (iv) Technological environment

It comprises of the various processes, techniques, approaches etc. by which an organization transforms inputs into output.

**Impact:** Digital watches have pushed out traditional watches.

#### (v) Legal Environment:

It characterises various governmental rules, regulations and legislations etc. that all members of business community must follow.

**Impact:** Removal of control on foreign exchange and liberalization of foreign direct investments.

2. **Ans.** Economic environment consists of factors likes inflation rates, interest rates, consumer's incomes, economic policies, market conditions etc. which affect the performance of a business firm.

Following are the main aspects of economic environment:

- (i) The role of public and private sector in the existing structure of the economy.
- (ii) The rate of increase in GNP and per capita income both at current and constant prices.
- (iii) Quantum of exports and imports of different products.
- (iv) Increase in transportation and communication facilities.
- (v) Trends in agricultural and industrial productions.
- (vi) Amount of savings and investments.

3. **Ans.** A business is a part of the society in which it operates. The buying and consumption habits of the people, their languages, customs, preferences, tastes etc. are the factors that influence the business. Businessmen should be alert enough to visualize the factors that directly or indirectly affect their organization. Cooperation between business and society will see business boom and will help growth of professional managers. The failure of any business organization in adapting to changes in the social environment will lead to dissatisfaction amongst its customers and rejection of its products. This shift of demand can even endanger the very survival of a business. For example, equal pay for male and female workers, demand for reservation in jobs for minorities and women etc.

4. **Ans.** The negative impacts of liberalization and globalization are as follows;

- (i) Threats from Multinational Companies (MNCs).
- (ii) Corporate vulnerability.
- (iii) Increased competition.
- (iv) Fast changing technology.
- (vi) High obsolescence of material resources.
- (vii) High labor turnover.
- (vii) Threat to indigenous culture and values.

5. **Ans.** The positive impacts of liberalization and globalization are as follow:



- (i) Opportunities for new entrepreneurs.
- (ii) Latest technology becoming available.
- (iii) Opening up of foreign markets.
- (iv) Easy imports of capital goods.
- (v) Direct investment by Indian companies abroad.
- (vi) Changed attitude of labor unions,
- (viii) Easy inflow of foreign capital.
- (ix) Freedom to expand and diversify.
- (x) Restructuring of industries.
- (x) Widening of product choices for consumers.

6. **Ans.** Following are the negative effects of liberalization and globalization.

- (i) Threats from multinational companies (MNCs)

With the arrival of multinationals it is becoming difficult for small and medium business units to even survive. The massive entry and consolidation to multinationals in the Indian markets is a challenge that has already forced some business enterprises to take the exit route.

- (ii) Destabilization of protected environment

With easier entry of multi-national companies, Indian business environment is fast losing its protective shield. The new entrepreneurial freedom is creating problems for the existing players. Even manufacturers of Maruti car could not retain their market share and had to remodel their products and announce heavily price reductions from time to time.

- (iii) Decline in public sector

Public sector is losing markets and their capacity utilization has declined, hampering thereby pace of country's technological and economic growth.

- (iv) Sellers' market turned into buyers' market

With the entry of foreign goods and services, shortage of goods, which is boon for the sellers, has now turned into surplus. Resultantly, sales/margin to any sellers have come down substantially. Buyers are now free to buy any product of their choice at a price they can afford.

- (v) Fall in the value of rupee

Indian rupee has been devaluing against DOLLAR, EURO and many other foreign

currencies. This phenomenon has forced even some established exporters to encase their stake partly/fully.

### Case Study Answer-

#### 1. Answer:

- a. Liberalisation and globalisation are the two major concepts related to government policy that have been discussed.

- **Liberalisation:** These economic reforms signalled the end of the licence-permit-quota raj and were aimed at liberalising the Indian business and industry from all unnecessary controls and restrictions.

- **Globalisation:** Globalisation means the integration of the various economies of the world leading towards the emergence of a cohesive global economy.

- b. The three impacts of reforms on Indian business and industry are outlined below:

- **Increasing competition:** The Indian firms are facing lot of competition due to changes in the rules of industrial licensing and entry of foreign firms. This change is more apparent in the sectors which were earlier reserved for private sector only like banking, insurance, telecommunications, etc.

- **More demanding customers:** With the easy availability of wider choice in purchasing better quality of goods and services due to high competition consumers have become more aware and demanding. The growing expectations of the consumers has increased the pressure on the business firms.

- **Rapidly changing technological environment:** With the entry of new firms which are far more superior in terms of technology the small firms are facing a lot of challenges. Moreover, the firms are constantly involved in innovating new products and upgrading present products with the help of better technologies in order to satisfy the customers demands.

**2. Answer:**

- a. Technological Environment is the component of business environment highlighted in the above Para. Technological Environment includes forces relating to scientific improvements and innovations which provide new ways of producing goods and services and new methods and techniques of operating a business.
- b. The two features of business environment as discussed by Professor Mehta with Naman and Govind are as follows:
  - **Dynamic nature:** It is dynamic in nature and keeps on changing due to technological upgradations, shifts in consumer preferences or increase in competition in the market.
  - **Inter-relatedness:** All the elements of business environment are closely interrelated. Therefore, any change in one element may necessitate corresponding changes in the other elements as well.
- c. The two points of importance of business environment as stated by Professor Mehta in the above situation are described below:
  - It enables the firm to identify opportunities and getting the first mover advantage: The dynamic business environment provides numerous opportunities for a business to evolve as per the changing needs.

Therefore, early identification of the forthcoming opportunities helps an enterprise to be the first to exploit them instead of losing them to the competitors.

- It helps the firm to identify threats and early warning signals: Sometimes the changes in the external environment may pose as a threat and hinder a firm's performance. An awareness about the business environment helps the managers to identify such threats on time and take necessary decisions and action.

**Assertion Reason Answer-**

1. a. Assertion and reason both are correct statements and reason is correct explanation for assertion.

**Explanation:** Business environment is dynamic, therefore it keeps on changing weather in terms of technological improvements, shifts in consumer preference or entry of new competition in the market.

2. a. Assertion and reason both are correct statements and reason is correct explanation for assertion.

**Explanation:** Environment happens to be the source of many threats. Environmental awareness can help managers to identify various threats on time and serve as an early warning signal.





# Planning | 4

## Meaning and Concept of Planning:

In simple words, planning is deciding in advance what is to be done, when where, how and by whom it is to be done. Planning bridges the gap from where we are to where we want to go. It includes the selection of objectives, policies, procedures, and programs from among alternatives. A plan is a predetermined course of action to achieve a specified goal. It is an intellectual process characterized by thinking before doing. It is an attempt on the part of manager to anticipate the future in order to achieve better performance. Planning is the primary function of management.

## Definition:

“Planning is an intellectual process, conscious determination of course of action, the basing of decision on purpose, facts and considered estimates.” - *Koontz O'Donnell*.



## Importance of Planning:

1. **Planning provides directions:** By stating in advance how the work is to be done planning provides direction for action. If there was no planning, employees would be working in different directions and the organization would not be able to achieve its goals efficiently.
2. **Planning decreases the chances of risk:** Planning is an activity which permits a manager to look forward and predict changes. By determining in prior the tasks to be completed, planning notes the way to deal with changes and unpredictable effects.
3. **Planning Reduces Over Lapping and Wasteful Activities:** Planning evaluates the alternatives uses of the available and prospective resources of the business and makes their must appropriate use.
4. **Planning Facilitates Decision Making:** Planning helps the managers to look into the future and make a choice from amongst various alternative courses of action.
5. **Planning Promotes Innovative Ideas:** The first role of management is planning. Managers are given the opportunity to generate fresh ideas, which can then be turned into tangible strategies. It directs all future actions that will lead to the company's growth and prosperity.
6. **Planning Establishes Standards for Controlling:** Planning establishes the benchmarks against which actual performance is assessed. As a result, planning is a must for controlling.

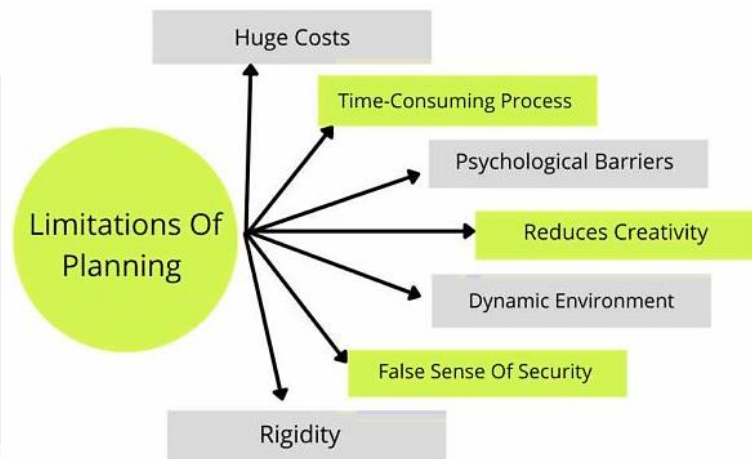
## Features of Planning:

1. **Planning focuses on achieving objectives:** Organizations set up with general goals and specific goals along with the plans and activities to be undertaken to achieve these goals.
2. **Planning is a Primary Function of Management:** Planning is the primary or first function to be performed by every manager. No other function can be executed by the manager without performing planning function.

3. **Planning is Pervasive:** Planning is essential for every sort of business activities. Every department whether, purchase, sales accounts, auditing, marketing etc. needs systematic planning.
4. **Planning is Continuous:** The planning cycle is linked to planning continuity. It indicates that a strategy is devised, implemented, and then followed by another strategy, and so on. Hence planning keeps on going and is a never-ending process.
5. **Planning is a Mental Exercise:** Planning necessitates the use of the mind and foresight. Rather than guesswork, planning is an intellectual activity that necessitates logical and organized thought.
6. **Planning involves decision making:** Planning essentially involves choice from among various alternatives and activities. If there is only one possible goal or a possible course of action, there is no need for planning because there is no choice.

**Limitations of Planning:**

1. **Planning Leads to Rigidity:** Once plans are made to decide the future course of action the manager may not be in a position to change them.
2. **Planning May Not Work in a Dynamic Environment:** Business environment is very dynamic as there are continuously changes. It becomes very difficult. to forecast these future changes. Plans may fail if the changes are very frequent.
3. **Planning Reduces Creativity:** With the planning the managers of the organization start working rigidly and they become the blind followers of the plan only.
4. **Planning Involves Huge Costs:** Planning process involves lot of cost because it is an intellectual process and companies need to hire the professional experts to carry on this process.
5. **Planning is a Time-Consuming Success:** Lot of time is needed in developing planning premises.
6. **Planning does not Guarantee Success:** Planning only provides a base for analyzing future. It is not a solution for future course of action.



**Steps in Planning Process:**

1. **Setting Objectives:** In planning function manager begin with setting up of objectives because all the policies, procedures and methods are framed for achieving objectives only.
2. **Developing Premises:** Premises refers to making assumptions regarding future. The assumptions are made on the basis of forecasting. Forecast is the technique of gathering information.
3. **Identifying Alternative Courses of Action:** After setting up of objectives the managers make a list of alternatives through which the organization can achieve its objectives.





4. **Evaluating Alternative Courses:** After making the list of various alternatives along with the assumptions supporting them the manager starts evaluating each and every alternative.
5. **Selecting an Alternative:** The best alternative is selected but as such there is no mathematical formula to select the best alternative. Sometimes instead of selecting one alternative a combination of different alternatives can also be selected.
6. **Implementing the Plan:** This is the step where other managerial functions also come in to the picture. The step is concerned with putting the plan into action i.e., doing what is required.

## Types of Plans:

### 1. Single Use of plan:

A Single use plan in a business refers to plan developed for a one-time project or event that has one specific objective. It applies to activities that do not reoccur or repeat. It is specifically designed to achieve a particular goal. Such plan is developed to meet the needs of a unique situation.

#### Types of Single Use Plan:

- (i) **Programmed:** A programmed is a single use plan containing detailed statements about project outlining the objectives, policies, procedures, rules, tasks, physical and human resources required to implement any course of action.
- (ii) **Budget:** A budget is a statement of expected result expressed in numerical terms for a definite period of time in the future.

### 2. Standing Plans:

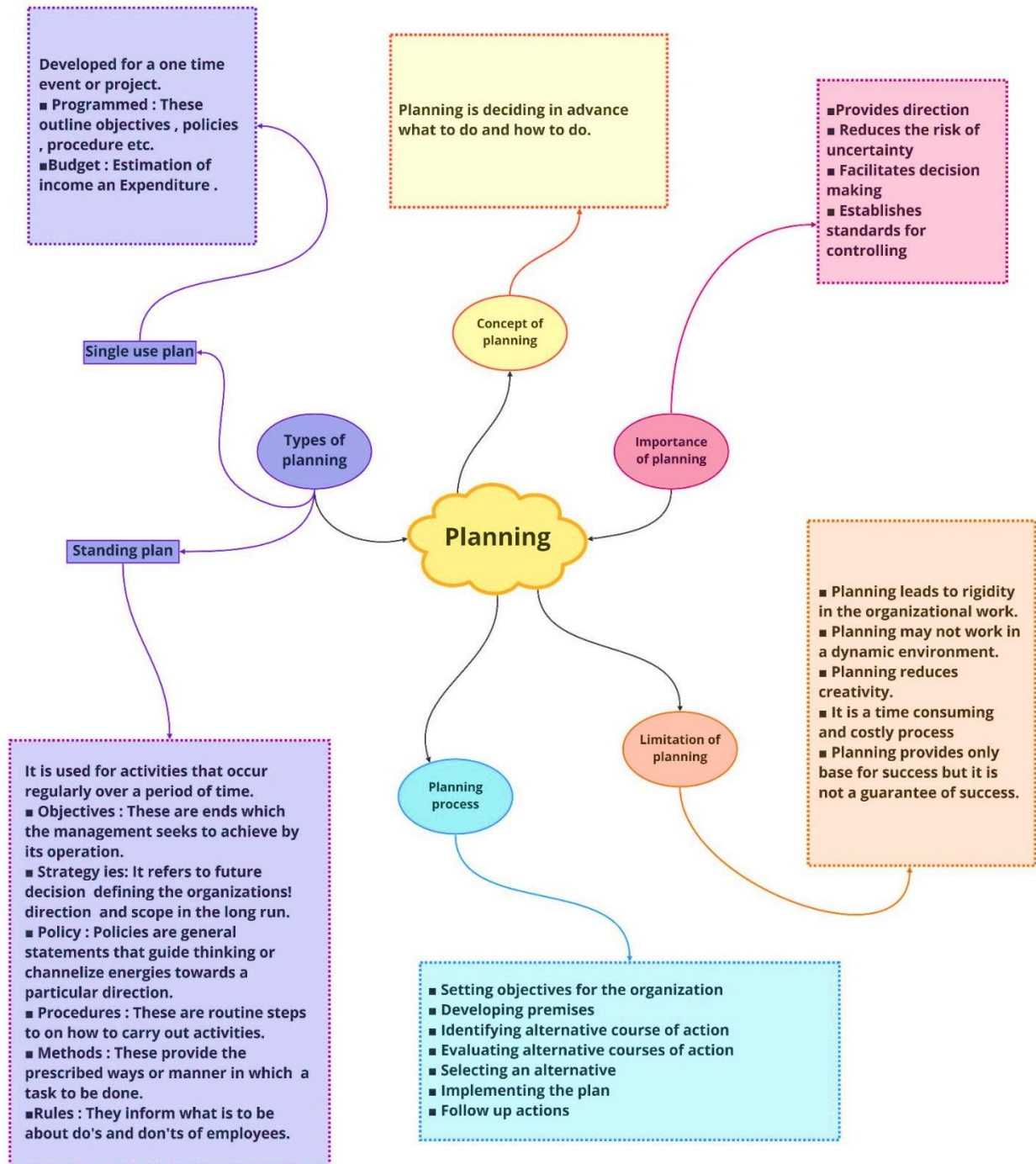
Standing plans are used over and over again because they focus on organizational situations that occur repeatedly. They are usually made once and retain their value over a period of years while undergoing revisions and updates. That is why they are also called repeated use plans.

#### Types of Standing Plans:

- (i) **Objectives:** Objectives are the ends towards which the activities are directed. They are the end result of every activity, e.g., increase in sale by 10%.
- (ii) **Strategy:** A strategy is a comprehensive plan to achieve the organizational objectives.
- (iii) **Policies:** Policies are general statements that guide thinking or channelize energies towards a particular direction.
- (iv) **Procedures:** Procedures are required steps established in advance to handle future conditions. The procedure can be defined as the exact manner in which an activity has to be accomplished.
- (v) **Method:** Methods provide the prescribed ways or manner in which a task has to be performed considering the objective.
- (vi) **Rule:** Rules are specific statements that inform what is to be done. They do not allow for any flexibility or discretion.



Class : 12th Business Studies  
Chapter-4 : Planning





## Important Questions

### Multiple Choice Questions-

- The first step of planning is \_\_\_\_\_
  - Selecting an alternative
  - Implementing the plan
  - Follow up action
  - Setting objectives
- No fine or penalty for violation is charged under \_\_\_\_\_
  - Rule
  - Law
  - Method
  - None of the above
- There are two types of plans \_\_\_\_\_
  - Single-use plan and Standing plan
  - Single-use and Double use plan
  - Traditional Plan and Modern Plan
  - Short term and Medium-term plan
- Plans can be implemented after the \_\_\_\_\_
  - Selecting an alternative
  - Setting objectives
  - Follow up action
  - Developing premises
- Which of the following is not a feature of planning?
  - Planning is time-consuming
  - Planning is pervasive
  - Planning is futuristic
  - To achieve objectives
- What is the last step in the planning process?
  - Follow up action
  - Setting objectives
  - Developing premises
  - None of the above
- If a firm has decided to sell its product on a cash basis only, it is part of firms \_\_\_\_\_
  - Procedure
  - Policy
  - Method
  - Objectives
- Planning is concerned with \_\_\_\_\_
  - Looking back
  - Looking old records
  - Looking new records
  - Looking forward
- Planning helps in reducing the \_\_\_\_\_
  - Direction for action
  - Decision making
  - Memory
  - Risk of uncertainty
- Planning seeks to bridge the gap between \_\_\_\_\_
  - Past and present position
  - Past and Future position
  - Present and Future position
  - None of the above
- Training, lectures and seminars are \_\_\_\_\_
  - Rules
  - Procedure
  - Strategy
  - Method
- What to do and how to do is concerned with \_\_\_\_\_
  - Controlling
  - Organising
  - Planning
  - None of the above
- Making decisions on the basis of experience, feelings, and accumulated judgment is called as \_\_\_\_\_
  - Decision making
  - Structured problems
  - Intuitive decision making
  - None of the above
- Estimated cash inflows and cash outflows are \_\_\_\_\_
  - Rules
  - Budget
  - Procedure
  - Programme
- Planning is a \_\_\_\_\_
  - Useless Function
  - One time process
  - Mental Exercise
  - Obsolete Concept

### Very Short-

1. What is planning?
2. Which function of management bridges the gap between where we are and where we want to go to?
3. Name the primary function of management.
4. One of the functions of Management is considered as base' for all other functions? Name that function.
5. What all qualities are required for doing planning?
6. Name the feature of planning which says planning is a forward looking function?
7. How does planning create rigidity?
8. What is the basis for creating future course of action?
9. Give one limitation of planning function.
10. Which is the most crucial step in planning process?

### Short Question -

1. What do you mean by planning?
2. What do you mean by a plan?
3. Enumerate six points of importance of planning.
4. How is planning a pervasive function of management?
5. How is planning forward looking?

OR

Planning is futuristic' explain?

6. Planning involves decision making". Explain.
7. 'Planning reduces creativity'. How?
8. 'Planning does not guarantee success'. Comment.
9. Enumerate the steps involved in the planning process.
10. What do you mean by objectives?

### Long Questions-

1. Defining 'organizational objectives' is the first step in the process of planning.

Explain, in brief, the other steps of this process.

OR

Explain the steps involved in the process of planning.

2. Differentiate between procedures and rules.
3. Explain the nature and characteristics of planning.

OR

"No enterprise can achieve its objective without systematic planning". Do you agree with the statement?

4. Why is planning necessary for effective management? Give reasons.

### Case Study Based Question-

1. In 2015, Naveen left his luxurious life in Mumbai, where he worked as a manager for Blue Birds Ltd. He shifted to Begampur, Chhattisgarh to fulfil his grandmother's dream of converting their 25-acre ancestral land into a fertile farm. For this, he set out specific goals along with the activities to be performed to achieve the goals. Every activity was a challenge since he was clueless about farming. He learnt every activity from filling the land to sowing the seeds. To aid farmers he launched his own company 'Innovative Agriculture Solutions Pvt. Ltd.'.

It was difficult initially as no one trusted an urban youth telling farmers about farming. But when everything was discussed in detail, the farmers started taking interest. He wanted to ensure that the future events meet effectively the best interests of the company. Through sales forecasting, he prepared an annual plan for production and sales.

He also found that the farmers grew only paddy, which was an activity of 3 - 4 months and the land remained idle for the rest 8 - 9 months of the year. He not only identified but evaluated various alternatives through which the farms could be utilised for the remaining months of the year. Through correct foresight and logical and systematic thinking based on analysis of all facts, all alternatives were examined and evaluated. He presented a plan to the farmers, where after harvesting paddy, vegetables could be grown. The above case highlights the features of one of the functions of management. By quoting lines from the above identify and explain these features.

2. Mr. Vinod, chairman of Vinod Construction Co., is involved in constructing residential flats in Ludhiana. Recently, he has got the contract of constructing 500 flats for which payment will be received in instalments from customers. He conducts a meeting with his architects, interior



decorators, staff and labour contractors like Mason, Electrician, Plumber etc. He gives the goal of constructing 500 flats within a year. After looking at disaster created by Nepal earthquakes, he instructed his architects to make arrangements for earthquake resistance building. Different departments were created for different nature of work and work was divided in such a way that it helps in avoiding confusion and misunderstanding. During summer season, lot of labour moves back from cities to their native places/ villages due to harvest season, so, provision of this should also be taken care of. Sometimes, as per the situation, managers have to choose among various alternative course of action. The managers are given the target of completing at least 10% of work every month and actual work done will be compared with the target and necessary action would be taken if deviations would be found there.

By quoting lines from the given paragraph link it to the various importance of planning as a function of management.

### Assertion Reason Question-

- In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.
    - Assertion and reason both are correct statements and reason is correct explanation for assertion.
    - Assertion and reason both are correct statements but reason is not correct explanation for assertion.
    - Assertion is correct statement but reason is wrong statement.
    - Assertion is wrong statement but reason is correct statement.
- Assertion (A):** Planning is a choice-making activity.
- Reason (R):** Planning involves selecting the best alternative out of various available options.
- In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.
    - Assertion and reason both are correct statements and reason is correct explanation for assertion.
    - Assertion and reason both are correct statements but reason is not correct explanation for assertion.
    - Assertion is correct statement but reason is wrong statement.
    - Assertion is wrong statement but reason is correct statement.
- Assertion (A):** Planning bridges the gap between where we are and where we want to go.
- Reason (R):** It involves setting objectives and developing appropriate courses of action to achieve these objectives.

## Answer Key

### MCQ Answers-

- Answer:** (d) Setting objectives
- Answer:** (c) Method
- Answer:** (a) Single-use plan and Standing plan
- Answer:** (a) Selecting an alternative
- Answer:** (a) Planning is time-consuming
- Answer:** (a) Follow up action
- Answer:** (b) Policy
- Answer:** (d) Looking forward
- Answer:** (d) Risk of uncertainty
- Answer:** (c) Present and Future position
- Answer:** (d) Method
- Answer:** (c) Planning
- Answer:** (c) Intuitive decision making
- Answer:** (b) Budget
- Answer:** (c) Mental Exercise

### Very Short Answers-

- Ans.** Planning is deciding in advance as to what needs to be done in future.
- Ans.** Planning.
- Ans.** Planning.
- Ans.** Planning
- Ans.** Intelligence, Imagination, Foresight, Sound Judgment.

6. **Ans.** Planning is futuristic.
7. **Ans.** Planning creates rigidity by putting adverse effect on initiative taken by the managers.
8. **Ans.** Forecasts.
9. **Ans.** Planning does not guarantee success.
10. **Ans.** Setting objectives.

### Short Answer -

1. **Ans.** Planning is deciding in advance about work to be done in future. It is that function of management which lays down the objectives and various actions to be taken for the achievement of those objectives. According to Koontz and O'Donnel "Planning is an intellectual process, the conscious determination of courses of action, the basing of decision on purpose, facts and considered estimated".
2. **Ans.** A plan is a formulation of certain steps and actions which are essential for achieving certain specific results. Plans can be classified on the basis of what they focus to achieve and the methods adopted viz. objectives, strategy, policy etc. For example, if the planned output for a week is 1,000 units and actual output is 580 units only, the planners have to critically review their plans and modify: them, if need be, so as to achieve the planned output.
3. **Ans.** Importance of planning is as under:
  - (i) It provides direction for action.
  - (ii) It reduces the risk of uncertainty
  - (iii) It facilitates decision making.
  - (iv) It establishes standards for controlling.
  - (v) It promotes innovative ideas.
  - (vi) It reduces overlapping and wasteful activities.
4. **Ans.** Planning is not the function of top management or any particular department only. It is required at all the levels of management and in all departments of an organisation. However the scope and nature of planning is different at different levels and in different departments. For example the top management lays down the plans for the organisation as a whole. Middle level management has to make plans for each department and the plans regarding the daily operations of an organisation are laid down by operational management.
5. **Ans.** Planning is always for the future and never for the past. It involves peeping in to future, analyzing and preparing plans accordingly. Thus, planning is futuristic as it helps in meeting likely future events effectively and efficiently to best advantage of the organisation.

For example, on the basis of sales forecasts, annual plans for production and sales are drawn.
6. **Ans.** Planning is essentially a process of making choice from among various alternatives. There will be no need for planning, if there is only one course of action, because there will be no choice. Hence need for planning depends on the availability of alternatives. A manager, after examining and evaluating the various alternatives, chooses the most appropriate one.
7. **Ans.** Usually in an organisation, planning function is performed by the top management and the rest of the members are required to implement these plans. As a result, middle management and other members are neither allowed to deviate from plans nor are they granted authority to act on their own. Hence most of the initiative and creativity in them gets reduced.
8. **Ans.** An organisation is successful only when the plans are effectively drawn and implemented.

A plan must be converted into action otherwise it becomes meaningless. Generally, it is seen that managers are in the habit of depending on previously tried and tested successful plans. But this practice sometimes does not work and may actually lead to failure instead of success.
9. **Ans.** Steps of planning are as follows:
  - (i) Setting up of objectives
  - (ii) Developing premises.
  - (iii) Identifying alternative courses of action.
  - (iv) Evaluating alternative courses
  - (v) Selecting an alternative.
  - (vi) Implementation of plan.
  - (vii) Follow up
10. **Ans.** Objective can be defined as a position where the management wants to reach in the future. These are the ends which an organisation wants to achieve through its operations. They are measurable in quantitative terms. For example, one objective of an organisation may be to increase sales by 20% and return on investment by 10% in the forthcoming year.



## Long Answers-

1. **Ans.** It has been rightly said that defining organizational objectives is the first step in the process of planning. Other steps in the process of planning are as follows:

(i) **Establish planning premises**

This step involves the establishment of planning premises in which plans are expected to operate. Planning premises are assumptions relating to future conditions and events which are likely to have an effect on achievement of goals

(ii) **Identifying alternative courses of action**

Under this step, various possible alternatives for reaching objectives should be identified by managers.

(iii) **Evaluating Alternative Courses**

This step involves deep evaluation of various alternative courses of action in light of the various objectives to be achieved. The positive and negative aspect of each alternative is evaluated.

(iv) **Selecting an alternative**

This step involves the selection of the most optimum and realistic plan with least negative results.

(v) **Implement the plan**

Under this step the best selected plan is put in to action.

(vi) **Follow up**

Under this step, it is monitored whether the plans are being implemented and whether the activities are being performed according to the schedule.

2. **Ans.**

Difference between procedures and rules

Basis	Procedures	Rules
1. Meaning	Procedure is a guide for action in a given situation.	Rule is a code of conduct governing or restricting flexibility or discretion
2. Nature	Procedures are specified in chronological order.	Rules do not place activities in chronological order

3. Purpose	The purpose of procedure is to facilitate and simplify the operation and eliminate duplication.	The purpose of rule is to maintain discipline in an organization.
4. Scope	The scope of procedures is wide because it has its own rules and regulations.	A rule has no procedure.

3. **Ans.**

### *Characteristics of Planning:*

- Goal Oriented:** Goals or objectives are the end results towards which activity is directed. The first stage of planning is the conscious and explicit statement of the ultimate objectives.
- Primacy of Planning:** Among various functions of management planning occupies the foremost position. Planning precedes the execution of all other managerial functions because it provides a frame of reference for future decisions. Allows managers to organize staff directly and control the activities necessary to achieve the organizational goals.
- Pervasiveness of Planning:** Planning is needed for all activities at all levels although the nature and extent of planning vary with the delegated authority or position a person is holding in the organizational hierarchy and with the board guidelines provided by his superiors.
- Intellectual Process:** Planning involves logical thinking and decision making. It implies determining what is to be done; how and when it is to be done and by whom. All these decisions require ability, experience, and foresightedness on the part of the management.
- Continuous function:** Planning is a continuous activity. As a matter of fact, the planning process continues so long as an enterprise is in existence.
- Flexibility:** Effective plans have an element of flexibility! Management can't afford to follow rigid plans in the era of fast changes in the technology market, government policy, etc.

As we all know, the resources of an organization are limited. Planning aims at providing the blueprints to optimum utilization of given resources to achieve the desired goals. Thus it can be concluded that no enterprise can achieve its objectives without systematic planning.

4. **Ans.**

Planning is important for better management of business planning determines objective, decides the course of action, removes uncertainty results in economics in operation, and makes control possible its importance is analyzed as below.

1. **Takes care of future uncertainties:** Future is full of uncertainties planning takes care of all future uncertainties and minimizes business risks since it makes effective use of forecasting techniques.
2. **Focuses attention on objectives:** All planning is directed towards achieving the objectives of an enterprise. Planning makes these objectives more concrete and tangible by determining the program's policies, procedures that provide guidelines to the employees to achieve these objectives.
3. **Facilitates decision making:** Decision making is the core of planning. It is the process of developing and selecting a course of action from among the various alternatives available. Planning provides a framework for decision-making by specifying the organizational objectives and planning premises.
4. **Facilitates Control:** Controlling is the process that measures current performance against desired standards to ensure that the objectives are attained according to plans. Control is always exercised in the light of planning which provides performance standards in quantitative terms.
5. **Promotes efficiency:** Proper planning ensures better utilization of organizational resources. Planning involves the selection of the best or most profitable course of action. This reduces the idle time for workers, machines, and so on.

6. **Helps in Co-ordination:** Planning is necessary for the organization as a whole. Derivative plans are prepared for each department within the limits of the master plan. Thus planning leads to the coordination of activities of all the departments in order to achieve the basic objective of the organization.

### Case Study Answer-

1. **Answer:**

The features of planning highlighted in the given case are as follows:

- Planning is goal-oriented. "For this, he set out ..... to achieve the goals."

Planning is a purposeful activity which contributes to the achievement of objectives for which an organisation is formed.

- Planning is futuristic. "He wanted to ensure ..... of the company."

Planning involves looking into future, analysing the conditions and predicting future events. The plans are drawn through forecasting and foreseeing the future events.

- Planning involves decision-making. "He not only identified ..... the year."

Planning involves decision-making as to which alternative course of action is the most suitable. During the process, alternative courses of action are evaluated and the most appropriate one is chosen.

- Planning is a mental exercise. "Through correct foresight ..... examined and evaluated."

The task of planning involves foresight, intelligent imagination and sound judgement. Thus, it is basically an intellectual activity of thinking rather than doing.

2. **Answer:**

- Planning provides directions. "Gives the goal of constructing 500 flats'.
- Planning reduces the risks of uncertainty. 'Instructed for earthquake resistance building'.



- Planning reduces overlapping and wasteful activities. 'Work divided among different departments'.
- Planning facilitates decision making. 'Choice among various alternative courses of action'.
- Planning establishes standards for controlling. 'Actual work done will be compared with target of 10% work completed per month and action would be taken for deviations.

### Assertion Reason Answer-

1. a. Assertion and reason both are correct statements and reason is correct explanation for assertion.
2. a. Assertion and reason both are correct statements and reason is correct explanation for assertion.





# Organising | 5

## Meaning of Organising

The organising function leads to the creation of an organisational structure which includes the designing of roles to be filled by suitably skilled people and defining the inter relationship between these roles so that ambiguity in performance of duties can be eliminated. The aim of organizing is to enable people to work together for a common purpose.

## Steps in the Process of Organising:

### 1. Identification & Division Of Work:

The first step in the process of organizing involves identifying and dividing the work in accordance with the predetermined plans. The work is divided into manageable activities so that duplication of work can be avoided and the burden of work can be shared among the employees.

### 2. Departmentalization:

- Once work is divided into small activities, similar and related jobs are grouped together. This grouping is called departmentalization.
- E.g. departmentalization on the basis of territory, products etc.

### 3. Assignment Of Duties:

- It is important to state clearly the work of different job positions and allocate work accordingly to employees.
- Once departments are formed, individual department heads are appointed for each departments.
- The work must be assigned to those who are best fitted to perform it well.
- E.g. finance job should be assigned to persons having qualifications and experience in finance e.g. C.A's or MBA finance.

### 4. Establishing Reporting Relationships

- Establishing authority and responsibility relationship helps to create a hierarchal structure and also helps in coordination amongst various departments.
- Superior subordinate relations between different people and job positions is to be created, so that everybody knows from whom he/she is to taking orders and to whom he/she can issue orders.

## Importance of organising:

### 1. Benefits of specialization:

- Organising leads to a systematic allocation of jobs amongst the work force.
- The division of work into smaller jobs reduces workload and enhance productivity and repetitive performance leads to specialization.

### 2. Clarity in working relationships:

- Organising helps in defining all the jobs and also clarifying the limits of authority and responsibility of each job. IMPORTANCE OF ORGANISING Benefits of specialization Clarity in working relationships Optimum utilization of resources Effective Administration Adaption to Change Development of Personnel Expansion and growth
- It helps in creating a hierarchical order thereby enabling the fixation of responsibility and specification of the extent of authority to be exercised by an employee.



### 3. Optimum utilization of resources:

- Organisation leads to usage of all natural resources, financial resources and human resources.
- The proper assignment of jobs avoids duplication of work and minimizes wastage of resources.

### 4. Effective Administration:

- It provides a clear description of jobs and related duties, which helps to avoid confusion and duplication of work.
- Clarity in working relationships enables proper execution of work, which results ineffective administration.

### 5. Adaption to Change:

- The process of organising is flexible which allows a business enterprise to accommodate changes in the business environment.
- It also provide stability to an enterprise.

### 6. Development of Personnel:

- A well designed organization structure encourages initiative and relative thinking on part of the employees.
- When managers delegate their authority, it reduces their workload and thus can give time on important areas of growth and opportunity to innovate thereby.

### 7. Expansion and growth:

- Organising helps in growth & diversification of an enterprise.
- By adding more job positions, departments, products lines, new geographical territories etc. and thus will help to increase customer base, sales and profit.

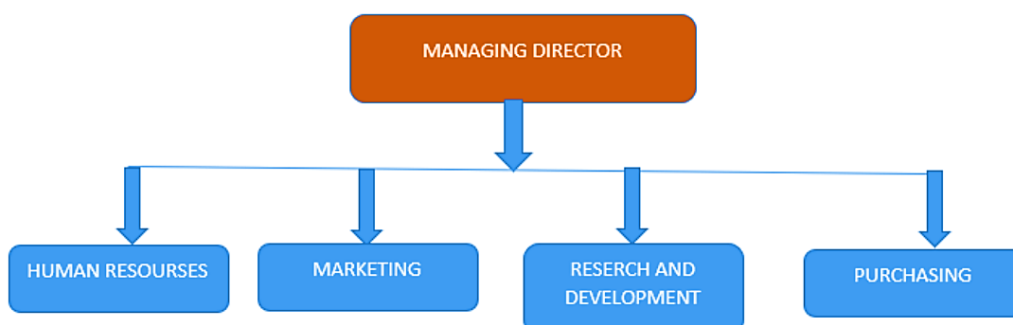


## Organisational Structure:

The organisation structure can be defined as the framework within which managerial and operating tasks are performed. It specifies the relationships between people, work and resources in an organisation. Under the organizational structure, various posts are created to perform different activities for the attainment of the predetermined objectives of the enterprise. The structure provides a basis or framework for managers and other employees to perform their functions. Span of management refers to the number of subordinates that can be effectively managed by a superior. The Span of management largely gives shape to the organization structure. This determines the levels of management in the structure.

### 1. Functional structure:

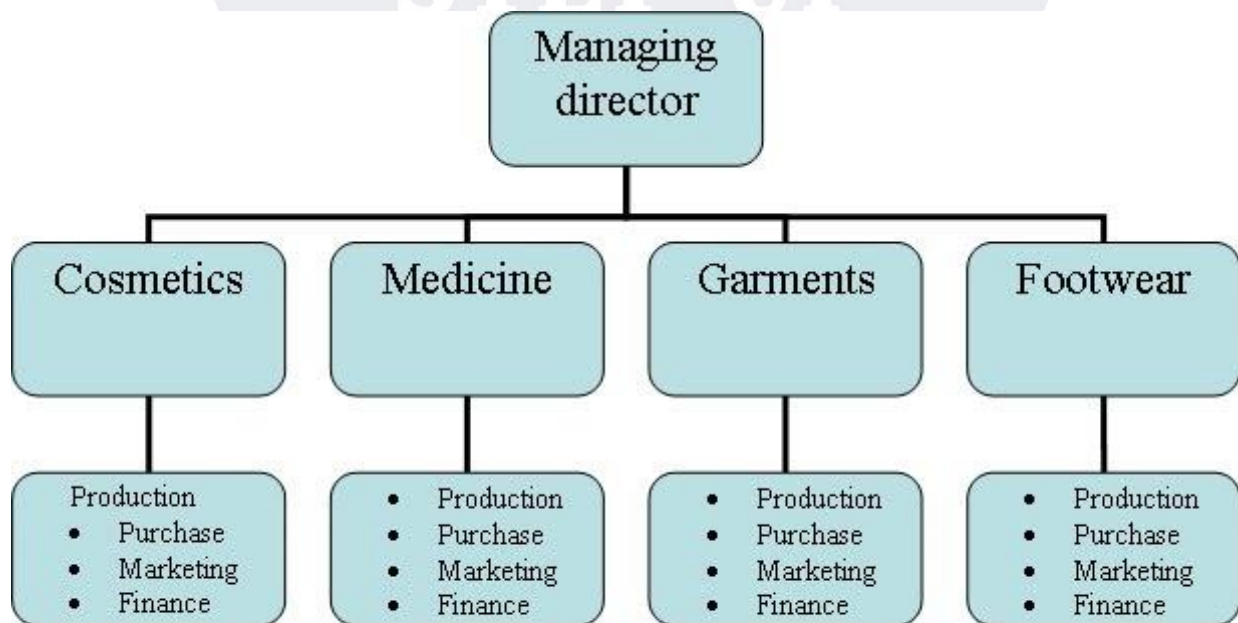
In functional structure activities are grouped and departments are created on the basis of specific functions to be performed. For example, all the jobs related to production are grouped under production department, sales departments etc.



ADVANTAGES	DISADVANTAGES	SUITABILITY
<ul style="list-style-type: none"> <li>• Functional structure leads to occupational specialisation since emphasis is placed on specific functions.</li> <li>• Promotes efficiency in the utilisation of man power.</li> <li>• Promotes control and coordination within a department.</li> <li>• It helps in increasing managerial and operational efficiency.</li> <li>• it reduces duplication of work.</li> <li>• It helps in training employees easily.</li> <li>• It ensures that different functions get due attention.</li> </ul>	<ul style="list-style-type: none"> <li>• A Functional structure gives more importance to the objectives of functional head than the objectives of organisation</li> <li>• Lack of coordination among different departments.</li> <li>• A conflict of interests will arise within different departments.</li> <li>• It may lead to inflexibility due to narrow perspective of employees.</li> </ul>	<ul style="list-style-type: none"> <li>• Organizations which require high degree of functional specialization with diversified activities.</li> <li>• Large organizations producing one line of product.</li> </ul>

**2. Divisional organisation structure:**

Dividing the whole enterprise according to the major products to be manufactured (like metal, plastic, cosmetics etc.) is known as divisional organisation structure.





### ADVANTAGES

- Product specialisation helps in the overall development of the skills of departmental heads.
- It helps in the fixation of responsibility and accountability of departmental heads
- provides a proper basis for assessing performance and results of each division.
- It facilitates expansion and growth, as new divisions can be added without interrupting existing divisions

### DISADVANTAGES

- Conflicts may arise among different divisions on allocation of resources.
- It may lead to increase in costs since there may be a duplication of activities in different product divisions.
- It provides managers with the authority to supervise all activities related to a particular division.

### SUITABILITY

- This structure is suitable in organizations producing multi product or different lines of products requiring product specialization.
- Growing companies which intend to add more lines of products in future adopt this structure.

### Comparative view: Functional and Divisional Structure:

Basis For Comparison	Functional Structure	Divisional Structure
Meaning	Functional Structure is one in which the reporting relationships of the organization are bifurcated according to their functional area.	An organizational structure wherein the organizational functions are classified into divisions as per product or service lines , market, is called Divisional Structure.
Basis	Functional areas	Specialized divisions
Responsibility	Difficult nsito fix respobility on a particular department.	Easy to fix responsibility for performance.
Autonomy of decisions	Managers do not have autonomy of decisions.	Managers have autonomy of decisions.
Cost	Economical, as the functions are not repeated.	Expensive as it involves repeation of resources.
Appropriate for	Small and simple organizations.	Large and dynamic organizations.

### 3. Formal organisation:

Formal organisation refers to the organisation structure that is designed by the management to accomplish organizational goals. In a formal organisation the boundaries of authority & responsibility is clearly defined and there is a systematic coordination among the various activities to achieve organizational objectives.

Features	Advantages	Disadvantages
<ul style="list-style-type: none"><li>• It clearly defines the lines of authority and responsibility for every individual in an organisation.</li><li>• It is a means to achieve the objectives specified in the plans.</li><li>• It is impersonal and doesn't take into consideration emotional aspect of the employees.</li><li>• it is designed by the top management.</li><li>• It is created with the motive of achieving organizational objectives.</li></ul>	<ul style="list-style-type: none"><li>• Easier to fix responsibility since mutual relationships are clearly defined</li><li>• It helps in avoiding duplication of work</li><li>• Unity of command is maintained</li><li>• Effective accomplishment of goals.</li><li>• Provides stability in organisation.</li></ul>	<ul style="list-style-type: none"><li>• May lead to procedural delays as chain of command has to be followed.</li><li>• Rigid policies reduces creativity.</li><li>• More emphasis is on structure and work than on human relationships.</li></ul>

### 4. Informal organisation:

Interaction among people at work gives rise to a 'network of social relationships among employees' called the informal organisation. The main purpose of this organization structure is the psychological satisfaction of the employees with common interests. For example, employees with similar interest in books, films, religion etc. may form their own informal groups.

FEATURES	ADVANTAGES	LIMITATIONS
<ul style="list-style-type: none"><li>• It originates from the personal interaction of employees within a organisation.</li><li>• The standards of behaviour evolve from group norms.</li><li>• It doesnt have fixed channels of communication.</li><li>• It emerges spontaneously and not created by management.</li><li>• It is a complex network of social relationships among members.</li></ul>	<ul style="list-style-type: none"><li>• It leads to faster spread of information and feedback as formal channels of communication is not followed.</li><li>• It enhances job satisfaction and a sense of belongingness in the organisation.</li><li>• It provide quick solutions to the problems.</li></ul>	<ul style="list-style-type: none"><li>• Informal organisation spread rumours, sometimes it goes against the interests of the organisation.</li><li>• It resists change and lays stress on adopting the old techniques.</li><li>• members of the group may give more priority to group interests over the organisational objectives.</li></ul>



## Difference between Formal Informal Organisation:

Basis of difference	Formal organisation	Informal organisation
Meaning	'Formal organisation' refers to the relationship between authorities as defined by the management.	Refers to the relationship based on personal and informal relationship among the employees.
Origin	The structure originates from the rules and policies of the management.	The structure originates from the social interactions among the employees.
Authority	Authority is defined by the profile and managerial positions.	Authority is defined by the personal qualities of the employees.
Flow of communication	Communication flows through the scalar chain.	No planned route of communication is followed.
Nature	Formal organisations are rigid	Informal organisations are flexible

## Delegation:



“Delegation of authority merely means the granting of authority to subordinates to operate within prescribed limits.” -**Theo Haimman**

Delegation refers to the downward transfer of authority from a superior to a subordinate employees. It is a pre-requisite to the efficient functioning of an organisation because it enables a manager to use his/ her time on high priority activities. Importance of delegation is that it helps in effective management, employee development, motivation, growth and coordination.

## Elements of delegation:

1. **Authority:** Authority refers to the right to take decisions in order to guide the activities of others. Authority determines the superior subordinate relationship. Laws and the rules and regulations of the organisation restrict authority. Authority flows downward.
2. **Responsibility:** Responsibility is the obligation of a subordinate to perform properly the assigned duty. If the subordinate has the responsibility for a job, he/ she must be given necessary authority to carry out that task.
3. **Accountability:** Accountability implies being accountable for the final outcome. When a superior assigns a work to a subordinate, he/she is answerable to the superior for its outcome.

### Difference between Authority, Responsibility and Accountability:

Basis	Authority	Responsibility	Accountability
1. Meaning	Right to command	Obligation to perform an assigned task	Answerability for outcome of the assigned task.
2. Origin	Arises from formal position	Arises from delegated authority	Arises from responsibility
3. Flow	Downward – from Superior to Subordinate	Upward – from Subordinate to Superior	Upward – from Subordinate to Superior
4. Withdrawal	Can be withdrawn anytime by giving notice.	Cannot be withdrawn once created.	Cannot be withdrawn once created.

### Importance of delegation:

- Reduction of Executives' work load:** It reduces the work load of officers. They can thus utilize their time in more important and creative works instead of works of daily routine.
- Employee development:** Employees get more opportunities to utilize their talent which allows them to develop those skills which will enable them to perform complex tasks.
- Quick and better decision are possible:** The subordinate are granted sufficient authority so they need not to go to their superiors for taking decisions concerning the routine matters.
- High Morale of subordinates:** Because of delegation of authority to the subordinates they get an opportunity to display their efficiency and capacity.
- Better coordination:** The elements of delegation – authority, responsibility and accountability help to define the powers, duties and answer ability related to various job positions which results in developing and maintaining effective coordination.

### Decentralisation:

“Decentralisation refers to systematic efforts to delegate to the lowest level, all authority except the one which can be exercised at central points”. -Louis Allen

Decentralisation means delegation of authority throughout all the levels of the organisation. This empowers lower levels to take decisions regarding problems faced by them without having to go to the upper levels. In other words decision making authority is given to all the employees at all levels depending on the job each one of them are handling.

An organisation is centralized when the decision making authority is retained by the top level management.

### Importance of decentralisation:

- Develops initiative among subordinates:** It helps to promote confidence and self reliance in the subordinates as they are given freedom to take their own decisions.
- Develops managerial talent for future:** Training given by the organisation and the experience gained from handling the projects increases the talent of the managers and employees.
- Quick decision making:** Since the managerial decisions are taken at all levels nearest to the point of action helps them to take better and quick decisions.
- Relieves the top management:** By the delegation of work, the daily managerial jobs are assigned to the subordinates, which leaves enough time with the superiors to look into priority areas.



5. **Facilitates growth:** It allows the departmental heads and employees to perform in the best possible manner considering all the aspects of their department, which in turn increases productivity, efficiency and facilitates growth.
6. **Better Control:** Evaluation of performance is possible at each level, which results in complete control over all the other activities.

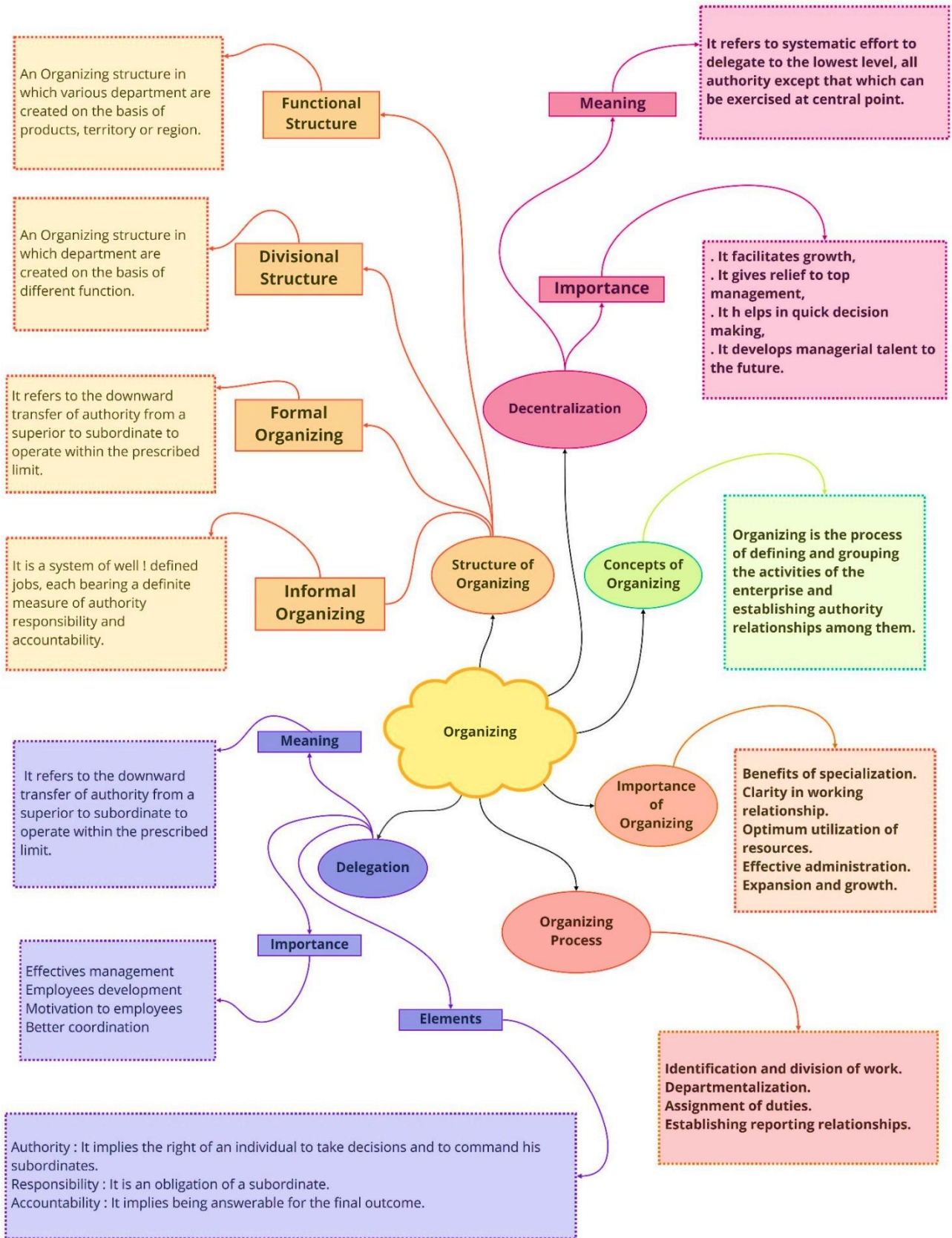
### Difference between Delegation and Decentralisation:

Basis for comparison	Delegation	Decentralisation
Meaning	Delegation means handing over an authority from one person of high level to the person of low level.	Decentralization is the final outcome achieved, when the delegation of authority is performed systematically and repeatedly to the lowest level.
What it is?	Technique of management	Philosophy of management.
Requirement	Yes, for all organization delegation of authority is very necessary.	No, it is an optional philosophy which may or may not be adopted by the organization.
Liberty of Work	Subordinates do not have full liberty.	A substantial amount of freedom is there.
Relationship	Creates superior-subordinate relationship.	A step towards creation of semi-autonomous units.





Class : 12th Business Studies  
Chapter-5 : Organizing





## Important Questions

### Multiple Choice questions-

- Authority, Responsibility and Accountability are the elements of \_\_\_\_\_
  - Decentralisation
  - Informal Organisation
  - Delegation
  - None of the above
- \_\_\_\_\_ is helpful in increasing the role of the subordinates in the organisation
  - Delegation
  - Decentralisation
  - Centralisation
  - None of the above
- The form of organisation known for giving rise to rumors is called
  - Centralised organisation
  - Formal organization
  - Decentralised organisation
  - Informal organisation
- Organisation establishes a relationship between
  - People, work, and resources
  - Customer, work, and resources
  - People, work, and management
  - Customer, work, and management
- Grouping of activities on the basis of functions is a part of
  - Decentralised organisation
  - Centralised organisation
  - Functional organisation
  - Divisional organisation
- Meaning of authority is \_\_\_\_\_
  - Subordinate to Superior relationship
  - Right to avoid taxes
  - Right to Command
  - None of the above
- The span of management refers to
  - Number of managers
  - Number of subordinates under a superior
  - Length of term for which a manager is appointed
  - Number of members in top management
- A tall structure has a
  - Narrow span of management
  - Wide span of management
  - No span of management
  - Fewer levels of management
- For delegation to be effective it is essential that responsibility be accompanied by necessary
  - Manpower
  - Incentives
  - Promotions
  - Authority
- Grouping of activities on the basis of product lines is a part of
  - Delegated organisation
  - Functional organisation
  - Autonomous organization
  - Divisional organisation
- Centralisation refers to
  - Opening new centers or branches
  - Retention of decision-making authority
  - Dispersal of decision-making authority
  - Creating divisions as profit centers
- The possibilities of inadequate profits or even losses due to uncertainties are known as \_\_\_\_\_
  - Business risks
  - Business contingencies
  - Business ventures
  - None of the above
- What is the last step in organising process?
  - Identification and division of work
  - Departmentalisation
  - Assignment of duties
  - Establishing reporting relationship
- Product Specialisation is concerned with \_\_\_\_\_
  - Functional Structure
  - Divisional Structure
  - Normal Structure
  - None of the above

15. A network of social relationship that arises spontaneously due to interaction at work is called:
- Informal organisation
  - Formal organisation
  - Delegation
  - Decentralisation

### Very Short-

- Name the organization which is deliberately created?
- Enumerate the steps in the process of organizing?
- Organizing helps in optimum utilization of resources. Which type of resources does it refer?
- Give any one importance of organizing?
- Divisional structure is more suitable for the firms having several products and each product has distinct features. Do you agree?
- Name the type of organization in which:
  - Friendly relationship exists among the members.
  - Official relationship exists among the members.
- Which term denotes "The number of subordinates that can be effectively managed by a superior?"
- What are the elements of delegation of authority?
- "A manager is of the view that he is not responsible for the quality of work that he has delegated to his subordinate". Do you agree with his view points? Justify your answer by giving arguments.
- Scope of decentralization of authority is wider than delegation. Why?

### Short Questions-

- Explain the term organization structure in brief.
- Differentiate between Formal organization and Informal organization?
- Name and explain the two steps in the process of organizing which come after 'Identification and division of work' and 'Departmentalization'.
- Aman Ltd. Is manufacturing toys and has production, sales, Purchase and Finance Departments. Which type of organization structure would you suggest to them? State any three advantages of this organization structure.

- Hindustan Ltd. is manufacturing computers, soaps and textiles. Which type of organizational structure would suit the requirements of such organization? State any three advantages of this organization structure.
- It is a network of personal and social relations not established or required by the formal organization but arising spontaneously as people associate with one another. Name this organization and give its three advantages.
- "Authority can be delegated but accountability cannot." Explain the statement.
- The Marketing Manager of an organization has been asked to achieve a target sales of 100 generators per day. He delegates the task to 10 sales managers working under him. Two of them could not achieve their respective targets. Is the marketing manager responsible? Briefly explain the relevant principle in support of your answer.
- If we delegate the authority we multiply it by two, If we decentralize it, we multiply it by money.
- "A manager is of the view that he is not responsible for the quality of work that he has delegated to his subordinate". Do you agree with his view points? Justify your answer by giving arguments.

### Long Questions-

- Explain the terms authority, responsibility, and accountability?
- Explain in brief the principles of delegation of authority?
- Differentiate between a delegation of authority and Decentralization?
- Explain in brief the matrix or Grid organization? Also, mention its merits and demerits.
- Explain the term Decentralization and mention its importance in business activities?
- Give the meaning of delegation of authority and its importance?

### Case Study Based Question-

- Aman Chadha started 'Bulls Eye' a company for providing cyber security solutions to businesses. Its objective is to prevent, detect and respond to cyber-attacks and protect critical data. He was a hardworking software engineer and an expert in cyber security. His reputation grew by leaps and bounds as he was not only a person of integrity but



also did his work with utmost honesty and sincerity. The business started growing day by day.

He was delighted when he was offered a big project by the Ministry of Defence. While working on the project, he found that the volume of work made it impractical for him to handle all the work by himself. He decided to expand the team. The company maintained a close liaison with a local engineering college. During a campus placement, Ishan and Vrinda were appointed to work for the new project.

He found the new employees capable, enthusiastic and trustworthy. Aman Chadha was thus, able to focus on objectives and with the help of Ishan and Vrinda, the project was completed on time. Not only this Aman Chadha was also able to extend his area of operations. On the other hand Ishan and Vrinda also got opportunities to develop and exercise initiative.

- a. Identify and briefly explain the concept used by Aman Chadha in the above case which helped him in focusing on objectives.
  - b. Also, state any four points of importance of the concept identified in (i) above.
2. Ramdas, aged 49 is working in an aviation company. He is the senior most employee in his division. He is even senior to the division manager, Kanaputti. Ramdas is considered one of the most committed, capable and hard-working employees. As a result of his abilities and seniority, he generally received the work assignments of his choice. Although there was no formal designation of various „special’ projects assigned to Ramdas, he handled them as a matter of routine. A problem developed when an able and intelligent person Nagarjuna, aged 33, was appointed by Kanaputti. Nagarjun’s previous three years’ experience in the closely related work, made it possible for him to catch on to the routine work of his new job more rapidly than was customary for a new employee. On several occasions, Kanaputti noticed the tension developing between the two employees. However, he didn’t want to get involved in their personal issues as long as the work was completed effectively and efficiently by them. One day, the tension between them reached the boiling point and Ramdas complained to

Kanaputti stating that his duties were being largely taken over by Nagarjun. Kanaputti issued the order stating the clear allocation of the jobs and related duties between the two. He further clarified the working relationship between them by specifying who was to report to whom. This helped in reducing the workload, enhancing productivity and removing ambiguity. (CBSE, Sample Paper, 2017)

- a. Identify and state the step of organizing process which has not been carried out properly and contributed to this problem.
- b. State the two steps of the organizing process which have been taken by Kanaputti to respond to the complaint of Ramdas.
- c. Also state two points of importance of organizing as reflected in the above case.

### Assertion Reason Question-

1. In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.
  - a. Assertion and reason both are correct statements and reason is correct explanation for assertion.
  - b. Assertion and reason both are correct statements but reason is not correct explanation for assertion.
  - c. Assertion is correct statement but reason is wrong statement.
  - d. Assertion is wrong statement but reason is correct statement.

**Assertion (A):** Delegation is an optional policy decision and is done at the discretion of top management.

**Reason (R):** No individual can perform all tasks on his own.

2. In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.
  - a. Assertion and reason both are correct statements and reason is correct explanation for assertion.
  - b. Assertion and reason both are correct statements but reason is not correct explanation for assertion.
  - c. Assertion is correct statement but reason is wrong statement.

d. Assertion is wrong statement but reason is correct statement.

**Assertion (A):** Organising helps in the growth and diversification of an enterprise.

**Reason (R):** It allows a business enterprise to add more job positions, departments and even diversify their product lines.

## Answer Key

### MCQ Answers-

1. **Answer:** (c) Delegation
2. **Answer:** (b) Decentralisation
3. **Answer:** (d) Informal organisation
4. **Answer:** (a) People, work, and resources
5. **Answer:** (c) Functional organisation
6. **Answer:** (c) Right to Command
7. **Answer:** (b) Number of subordinates under a superior
8. **Answer:** (a) Narrow span of management
9. **Answer:** (d) Authority
10. **Answer:** (d) Divisional organisation
11. **Answer:** (b) Retention of decision-making authority
12. **Answer:** (a) Business risks
13. **Answer:** (d) Establishing reporting relationship
14. **Answer:** (b) Divisional Structure
15. **Answer:** (a) Informal organization

### Very Short Answers-

1. **Ans:** Formal Organisation
2. **Ans:**
  1. Identification and division of work
  2. Grouping Jobs and Departmentalization
  3. Assignment of duties
  4. Establishing authority relationship
3. **Ans:** All material, financial and human resources.
4. **Ans:** Development of personnel.
5. **Ans:** Yes, I do agree.
6. **Ans.** a) Informal Organisation b) Formal Organisation.
7. **Ans:** Span of control.
8. **Ans:** Responsibility, Authority, Accountability.
9. **Ans:** No I do not agree with managers view point.

The reasons are as follows:

- i) Principle of delegation by results expected.
  - ii) Principle of parity of authority and responsibility
  - iii) Principle of absolute responsibility.
  - iv) Authority level principle
10. **Ans:** Decentralization implies extension of delegation to the lowest level of management.

### Short Answers-

1. **Ans.** Organization structure: The organization structure can be defined as the framework within which managerial and operating tasks are performed. It specifies the relationships between people, work, and resources. It allows coordination among human, physical and financial resource to accomplish the desired goals.

An organization structure provides the framework which enables the enterprise to function as an integrated unit by regulating and coordinating the responsibilities of individuals and departments.

According to Peter Drucker, the Organization structure is an indispensable means, and the wrong structure wins seriously impair business performance and even destroy it.

The organization structure can be categorized as –

1. Functional structure
2. Divisional structure.

2. **Ans.**

Basis	Delegation of authority	Decentralization
1. Nature	It is the first step towards decentralization	Decentralization is the last step in the process of delegation. It includes delegation.



2. Freedom to make decisions	Under delegation, subordinates have to follow the directions given by their superiors while making decisions.	Under decentralization, subordinates are free to take decisions
3. Scope	Its scope is limited since it refers to entrusting some part of the authority by the superior to his nearest subordinate on a personal basis.	Its scope is wide since it refers to the wide dispersal of authority to all levels in the entire organization.
4. Routine or important	It is considered to be the routine task of managers.	It is considered to be the very important decision of organizational arrangement.
5. Transfer of Responsibility	Under it, only the authority is transferred and not the responsibility. The ultimate responsibility lies with the delegator.	Under it, authority, as well as responsibility, is transferred. Subordinates are independently responsible for their performance.
6. Power to Control	In it superior has the power to exercise control over his subordinates.	In it superior loses the power to control his subordinates.
7. Temporary or permanent	It is a temporary arrangement where the authority is taken back after the assigned task is completed.	It is a permanent feature where the authority is granted for the future also.
8. Essential or optional	It is essential for all types of organizations because no superior can get the things done from his'	It is optional because it is not necessary' that the superior must disperse his authority in a systematic

	subordinates without delegating sufficient authority to them.	manner throughout the entire organization.
9. Dependence	Decentralization is not essential for delegation i.e. delegation does not depend on decentralization	Delegation is essential for decentralization, i.e. it depends on delegation.

3. **Ans:** Identification and division of work: Dividing the total work into jobs is necessary because the entire work cannot be done by individual (ii) departmentalization: In this step combine or group similar jobs into larger units called departments.
4. **Ans:** I would suggest functional structure for Aman Limited.  
**Advantages of this structure:**
- Supervision is facilitated.
  - Coordination within the department is easier.
5. **Ans:** Divisional structure would meet the requirements of Hindustan limited.  
**Advantages:**
- All activities associated with one product can be easily integrated.
  - Decision making is faster and effective.
  - Performance of individual product can be easily assessed.
6. **Ans:** Informal organization:  
**Advantages:**
- It brings feeling of belongingness.
  - Informal organization satisfies social and cultural needs.
  - It provides useful channel of communication.
7. **Ans:** According to the principle of absolute responsibility, authority can be delegated but responsibility cannot be delegated by a manager. The manager remains responsible to his own superior for the task which he may assign to his subordinates. Every superior is responsible for the acts of his subordinates to whom he delegates authority for any work.

8. **Ans:** Yes, Marketing manager is responsible for the non-achievement of the target sales to his superior.

The principle related to this statement is absolute responsibility. It states that authority can be delegated but responsibility cannot be delegated by manager. The manager remains responsible and is accountable to his own superior for the task which he may have assigned to his subordinate.

9. **Ans:** Scope of delegation of authority is limited. It is clear that if we delegate the authority we multiply it by 2 that is delegator and his subordinate to whom authority is delegated. Scope of decentralization of authority is wider than delegation. It involves many people from top level to bottom lower level of authority.
10. **Ans:** No I do not agree with managers view point. The reasons are as follows:
- Principle of delegation by results expected.
  - Principle of parity of authority and responsibility
  - Principle of absolute responsibility.
  - Authority level principle

### Long Answers-

1. **Answer:** Meaning and definition of Authority: Management is getting work done through others. This is not possible unless the managers get the adequate authority to get work done through others. No manager can get work successfully executed through his subordinates in the absence of suitable authority. Authority refers to the right to make decisions and to get the decisions carried out. It is the right to act.

In the field of management, authority means the right to give orders to the subordinates and the power to get them executed for the attainment of organizational goals. Various scholars have defined authority in the following different ways

According to Henry Fayol, "Authority is the right to give orders and the power the exact obedience."

According to George R. Terry, "Authority is the power to exact other to take actions considered appropriate for the achievement of predetermined objectives."

According to Herbert A. Simon, "Authority may be defined as the power to make decisions which guide the actions of another. It is a relationship

between two individuals, one superior; the other subordinate. The superior frames and transmits decisions with the expectation that these will be accepted by the subordinate. The subordinate executes such decisions and his conduct is determined by them."

**Responsibility:** According to Theo Hamman, "Responsibility is the obligation of the subordinate to perform the duty as required by his superior."

According to Davis, "Responsibility is an obligation of the individuals to perform assigned duties to the best of his ability under the direction of his executive."

Thus, responsibility is the obligation of an individual to perform a particular work that arises from the formal relationship of a superior and a subordinate in an organization.

**Accountability:** When an individual works under some other person, he also becomes answerable to such officer for the proper discharge of his responsibilities. A superior can requisite an account of results from his subordinate of the duties assigned to him. The subordinate has a responsibility to give information and render a report of the task performed by him. Such responsibility is known as accountability.

According to Davis and Filley, "Each member in the organization is obliged to report to his superior how well he has exercised responsibility and made use of authority delegated to him."

Thus, it is clear that accountability arises out of responsibility and goes hand in hand with it.

2. **Answer:** Delegation is an important instrument in the process of organization and management, requires a few precautions and principles to be followed on the part of the delegator and the delegatee. Some principles are as follows

1. **Principle of Parity of Authority and Responsibility:**

When somebody is assigned any task, he must also be given adequate authority to perform such a task. For example, if a sales manager is assigned the task of doubling the sales, he must also be given the authority of advertising, appointing salesmen, selecting the channel of distribution, deciding the discount on sales, and incurring selling



expenses. The parity of authority and responsibility does not mean that if sales are to be doubled, the selling expenses should be commensurate with the responsibility. If the authority is more than responsible, it shall lead to its misuse.

2. **Responsibilities cannot be delegated:**

No superior can evade his responsibilities simply by delegating his authority to subordinates. The ultimate responsibility lies with the superior who delegates the authority. The flow of responsibility is from bottom to top, thus after delegating authority superior remains accountable for the activities of his subordinates towards his own superiors. Similarly, the subordinates remain accountable to their superiors for the performance of assigned duties.

3. **Principle of Clarity of Authority and Responsibilities:**

It is a very important concept in the area of delegation. The subordinates should be well clear about their rights and responsibilities. It will help them in knowing their area of operation and the extent of freedom of action. So, that there shall arise no conflict between different persons.

4. **Principle of the standard of performance:**

A subordinate can be self-responsible for failure only when certain standards are established for measuring his performance and such standards are made clear to the subordinates while assigning the work. The subordinate should be well aware of what is expected of him and what type of results should be shown. A delegation without control is like a wild horse without reins. Determination of the standards of performance helps the subordinate in being alert and prudent towards his responsibilities.

5. **Principle of Unity of Command:**

According to Earnest Dale, every individual should receive orders from only one individual and he should be responsible only towards him. If an employee receives orders from many individuals then he shall get confused about whose orders to obey and whom to report to. A person with more than

one boss is like a pawn in a game of chess.

6. **Authority level principle:**

This principle implies that a subordinate should have complete authority to make decisions at his level or position. If the subordinate has to take the approval of his superior even for small matters then his performance shall be hampered. This is also known as the exception principle.

7. **Scalar principle:**

According to this principle, authority and responsibility should; move in a straight line from the superior to the subordinate. This principle should be well considered while resorting to the delegation. For example, if there are four persons A, B, C, and D in a straight line and ' if A wants to delegate to C or D, he cannot do so. As per the principle of Scalar chain, A will first have to delegate to B, who in turn will delegate to C and then C will delegate to D. If a superior delegates some work to the subordinate next to the most immediate one then the immediate subordinates shall have an inferiority complex and will not cooperate fully.

8. **Principle of completeness of Delegation:**

Once a decision is taken as to which tasks are to be assigned, it is important that an individual should be assigned an entire task. There should be no splits i.e., the responsibility for the same task should not be assigned to more than one individual. Otherwise, there will be confusion of authority and responsibility.

3. **Answer:** The distinction between Decentralisation and Delegation of authority. Though decentralization is the expanded form of delegation, there is a considerable difference in them. Decentralization is much more than delegation. Louis A. Allen says, when a person hands over his work to others it is known as delegation but it will be known as decentralization only when the authority to complete the entire work is handed over to them.

For example, when the chief executive of a company hands over the responsibility to make appointments in his department to a particular manager, it is known as delegation. But when all the departmental managers are given authority to



make appointments in their respective departments, it is known as decentralization. The extent of decentralization increases when the departmental managers extend this authority to the executives below them:

The distinction between Delegation of authority and Decentralisation. Delegation of authority

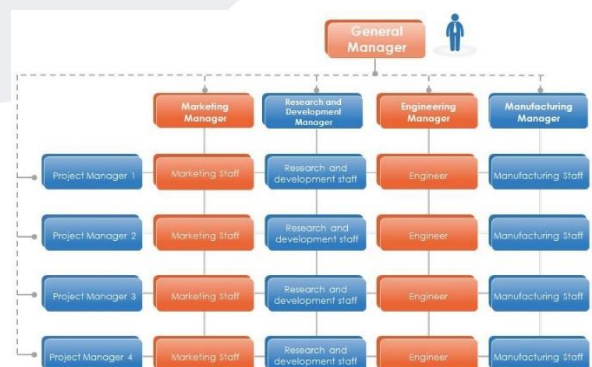
Basis	Formal organization	Informal organizations
(1) Formation	It is formed by the top management in a thoughtful and organized way.	It is formed automatically due to the social relationship.
(2) Purpose	Its main purpose is the achievement of the objectives of the organization efficiently.	Its main purpose is the fulfillment of individual needs and to protect their mutual interests.
(3) Nature or Structure	The activities, rights, and responsibilities are clearly defined in such organizations.	The rules are neither written nor clearly defined.
(4) Authority	In such an organization authority is derived from assigned positions and from above.	In this authority is derived from the acceptance and capabilities of an individual.
(5) Flow of authority or Communication	This authority flows from top to bottom.	This authority flows from top to bottom or horizontally.
(6) Behaviour of Members	In this organization, the relation among employees is according to the position and functions. Thus, the behavior is highly formal.	In this organization, there exists a personal relationship among members. Thus the behavior among them is informal.

(7) Tenure	Due to the establishment of the organization on some logical planning, the tenure is relatively	Since it is based on personal and mutual relationships it is highly flexible and temporary.
(8) Use of organization charts	In this, an organization chart is prepared to present the position of authority and responsibility.	No organization chart is prepared
(9) Size	They can be huge in size.	They are mainly small in size.

4. **Answer:** Matrix or Grid organization:

When the size and operational field of any organization are too wide and the number of products produced by it and its number of customers is large, it cannot be divided on any of the bases mentioned above. In such a situation, a matrix organization is established. Such organizations are divided on the basis of functions like the production department, purchase department, sales department, finance department, personnel department, etc. Besides this, a separate Project Manager is appointed for different projects.

This is explained through the diagram given below-



From the above diagram, it is clear that a separate Project Manager is appointed to complete the project quickly like Project A, Project B, Project C, etc. The project manager is given full responsibility for that particular project and all



the other departmental; officers are instructed to co-operate with him. Project Managers make plans for the project and undertake all the functions of organizing, control, direction, etc. The project manager is responsible for the success or failure of the project. The middle level and lower level officers work under the control of the project manager until the completion of the project and get involved in their normal activities after the completion of the project.

Thus in a matrix organization, two types of organizational structures work together – Functional and Project. Project managers do not wholly use the services of middle level and lower level officers but make use of their services temporarily according to their needs.

#### **Advantages of Matrix Organisation:**

1. **Quick Completion of the Project:** The project manager makes plans for all the activities of the project like giving orders, direction, etc. Thus the project gets completed quickly.
2. **Advantages of Functional as well as project departmentation:** Advantages of two types of organization-functional and project, can be availed of Project managers are the experts in their own field and they have the full co-operation of other officers.
3. **Flexibility:** Such type of organization is flexible as it can be easily implemented without bringing many changes in the existing organizational structure.
4. **The economy in costs:** There is no need of appointing special staff for each project. Services of departmental officers can be utilized as and when needed by the project manager which leads to economy in costs.

#### **Disadvantages of Matrix organization:**

1. **Violation of the Principle of Unity of Command:** The principle of unity of command is not followed because the officers are responsible to their superior as well as to the project manager. Thus they have to follow more than one boss.
2. **The problem of coordination:** There is a problem of coordination between the functions of departmental officers and project managers. There arises a conflict between the functions of the two because

departmental officers give priority to the activities of their own department whereas project managers give priority to their project work.

3. **Lack of Fixation of Responsibility:** On non-completion of the project, in time, the project managers normally complain of non-cooperation of the departmental officers.
4. **The problem of communication:** The problem of internal communication arises.
5. **Answer: Decentralization:**

Decentralisation of authority means systematic dispersal of authority in all departments and at all levels of management. According to Louis Allen decentralization is “the systematic effort to delegate to the lowest levels all authority, except that which can be exercised at central points”. An organization is said to be decentralized when managers at middle and lower levels are given the authority to make decisions and actions on matters relating to their respective areas of work. The top management retains the authority for taking major decisions and formulating policies for the organization as a whole. Top management also retains authority for overall coordination and control of the organization.

For example, let us take the case of a large steel manufacturing company. The board of directors and managing director of the company lay down the overall objectives and policies of the enterprise. Major decisions on product lines, capital investment, marketing methods are taken by the respective heads of departments. The marketing manager, for instance, is authorized to decide the quality and prices of products, channels of distribution, advertising methods, and organizing sales campaigns. The top management of the company does not interfere with his authority. However, departmental managers are required to keep in view the overall policies of the company while making decisions on matters within their authority. This is how a decentralized organization works.

Centralization and decentralization are opposite terms. They should not be confused with the location of work. An organization having branches in different cities may be centralized. Similarly, a company; maybe decentralized even though all its offices are located in one budding.

Centralization and decentralization are relative terms. No organization can be completely centralized or completely decentralized. They exist together.

For example, even in a decentralized organization, the top management retains the authority for overall policy decisions to ensure coordination and control. The degree of centralization and decentralization differs from one organization to another. According to Henri Fayol, "Everything which goes to increase the subordinates. the role is decentralization; everything which goes to decrease it is centralization."

Importance of Decentralisation:

The main benefits of decentralization are as follows –

1. **Reduction in Burden of Top Executives:** Decentralisation helps to reduce the workload of top executives.

They can devote greater time and attention to important policy matters by decentralizing authority for routine operational decisions.

2. **Motivation of subordinates:** Decentralisation helps to improve the job satisfaction and morale of lower-level managers by satisfying their needs for independence, participation, and status. It also fosters team-spirit and group cohesiveness among the subordinates.

3. **Better Decisions:** Under decentralization, the authority to make decisions is placed in the hands of those who are responsible for executing the decisions, as a result, more accurate and faster decisions can be taken as the subordinates are well aware of the realities of the situation. This avoids red-tapism and delays.

4. **Growth and Diversification:** Decentralisation facilitates the growth and diversification of the enterprise. Each product division is given sufficient autonomy for innovations and creativity. The top management can extend leadership over a giant enterprise. A sense of competition can be created among different divisions or departments.

5. **Development of managers:** When authority is decentralized, subordinates get the

opportunity of exercising their own judgment. They learn how to decide and develop managerial skills. As a result, the problem of succession is overcome and the continuity and growth of the organization are ensured. There is a better utilization of lower-level executives.

6. **Effective communication:** Under decentralization, the span of an organization is wider and there are fewer levels of an organization. Therefore, the communication system becomes more effective. Intimate relationships between superiors and subordinates can be developed.

7. **Efficient supervision and control:** Managers at lower levels have adequate authority to make changes in work assignments, rechange production-schedules, recommend supervision, and take disciplinary actions. Therefore, more effective supervision can be exercised. Control can be made effective by evaluating the performance of each decentralized unit in the light of clear and predetermined standards. Decentralization permits management by objectives and self-control.

8. **Democratic Management:** Decentralisation of authority distributes decision making authority at all levels and in all departments. Therefore, it creates democracy in the management of an organization. People at all levels are involved in decision making.

Decentralization, may, however, create problems of coordination and control. It is costly to set up semiautonomous departments and divisions. Lack of competent managers at middle and lower levels hinders decentralization. The degree of decentralization varies from one organization to another. It may also change from one time period to another in the same organization.

6. **Answer: Meaning of Delegation of Authority:**

Delegation of authority takes place when a manager assigns a part of his work to others and gives them the authority to perform the assigned tasks. The manager who delegates authority holds his subordinates responsible for the proper performance of the assigned tasks. Thus, the



process of delegation involves assigning duties, entrusting authority, and imposing responsibility on subordinates.

Some popular definitions of the delegation are given below –

- Delegation of authority merely means granting of authority to subordinates to operate within prescribed limits. Theo Haimann
- Authority is delegated when enterprise discretion is vested in a subordinate by a superior. The entire process of delegation involves the determination of results expected, assignment of tasks, transfer of authority for the accomplishment of these tasks, and the exaction of responsibility for their accomplishment. – Koontz and O' Donnell.

#### Importance of Delegation:

When the size of an organization expands, a manager alone cannot do all the work himself. He has to share his work and authority with others. An executive can extend his personal capacity through delegation of authority. Delegation is the means by which a manager can get results through others. Failure to delegate reduces the efficiency of the individual and blocks the development of his juniors. How one delegate determines how one manages. Just as authority is the key to the manager's job, delegation is the key to the organization.

The main advantages of the delegation are as follows –

1. **Relief to Top Executives:** Delegation of authority enables a manager to share his workload with his subordinates. It reduces the burden of work on senior executives. By transferring routine work to subordinates, a manager can concentrate on important policy matters. He can, therefore, make better use of his valuable time and ability. Delegation facilitates the proper distribution of workload as it takes place at all levels. The manager who delegates authority can achieve greater results than the one who does not. This is because by delegating authority, a manager secures the cooperation and participation of his subordinates.

2. **Scalar Chain:** Delegation of authority creates a chain of superior-subordinate relationships among managers. It provides meaning and content to managerial jobs. It also directs and regulates the flow of authority from the top to the bottom of an organization. It serves as a basis of superior-subordinate relations.
3. **Specialization:** Through delegation, an executive can assign jobs to his subordinates according to abilities and experience. In this way, he can obtain the benefits of the division of work.
4. **Quick Decisions:** When authority is delegated, lower-level employees can take decisions quickly without consulting senior executives. Subordinates are better in touch with local conditions and can take more practicable decisions within the policy framework laid down by top management.
5. **Motivation:** Delegation provides a feeling of status and importance to subordinates. Their independence and job satisfaction increase due to the authority they enjoy. They become more willing to work hard and achieve the targets laid down by higher authorities. Thus, delegation promotes a sense of initiative and responsibility among employees. It inspires employees to make full use of their skills.
6. **Executive Development:** Delegation gives an opportunity to employees to learn decision-making and leadership skills by exercising authority. It helps to improve the quality of personnel at lower levels because they are required to handle situations and solve managerial problems. They acquire competence and problems and can take up higher responsibilities in course of time. In this way, the delegation of authority is a means of developing future managers.
7. **Growth and Diversification:** Delegation of authority facilitates expansion and growth of the organization. As the quality of managerial talent improves, the organization can face future challenges better. It can grow and expand to a bigger size.

#### Case Study Answer-

1. **Answer:**
  - a. Delegation of authority is the concept used by Aman Chadha in the above case which helped him in focusing on objectives. Delegation of

authority is the process of granting of authority to the subordinates to operate within prescribed limits.

b. The four points of importance of delegation of authority are described below:

- **Effective management:** It helps the managers to function more efficiently as they get more time to concentrate on important matters. Freedom from doing routine work provides them with opportunities to excel in new areas.
- **Employee development:** By empowering the employees, they are given more opportunities to utilise their talent and this may help them to become better leaders and decision makers in future.
- **Motivation of employees:** Delegation also has psychological benefits as helps in building the self-esteem of an employee and improves his confidence and work performance. When a superior entrusts a subordinate with a task, it is not merely the sharing of work but involves trust on the superior's part and commitment on the part of the subordinate. Thus, delegation may give rise to latent abilities in the subordinates.
- **Facilitation of growth:** With the increase in the competence of the employees, an organisation tends to gain in many ways. The growth and expansion of the firm becomes easy as the capable workforce is ready to take greater responsibilities.

## 2. Answer:

a. The step of organizing process which has not been carried out properly and contributed to this problem is Assignment of duties. Assignment of Duties: Once departments

have been created each of them is placed under the charge of an individual and then jobs are allocated to the members as per their job positions.

b. The two steps of the organizing process which have been taken by Kanaputti to respond to the complaint of Ramdas are listed below:

- Assigning the duties
- Establishing reporting relationship.

c. The two points of importance of organizing as reflected in the above case are described below:

- **Optimum utilization of resources:** Organising ensures best possible use of all forms of resources i.e. physical, financial and human resource. It ensures systematic assignment of jobs thereby curbing overlapping of work and avoiding possibilities of duplication of work. This helps in preventing confusion and minimising the wastage of resources and efforts.
- **Adaptation to change:** The process of organising provides stability to the enterprise as it can then continue to survive and grow inspite of changes in the business environment. It enables the organisation structure to be suitably modified and the revision of inter-relationships amongst managerial levels to pave the way for a smooth transition.

## Assertion Reason Answer-

1. d. Assertion is wrong statement but reason is correct statement.
2. a. Assertion and reason both are correct statements and reason is correct explanation for assertion.





# Staffing | 6

## Meaning:

Staffing means putting people to jobs. It begins with human resource planning and includes different other functions like recruitment, selection, training, development, promotion, and performance appraisal of work force.

## Importance of Staffing:

1. **Efficient Performance of Other Functions:** For the efficient performance of other functions of management, staffing is its key. Since, if an organization does not have the competent personnel, then it cannot perform the functions of management like planning, organizing and control functions properly.
2. **Maximum and Efficient Utilization of Resources:** Staffing plays an important role in maximum and efficient utilization of resources. Because in every organization all the resources like, money, material and machine etc. are utilized efficiently through specialized manpower and specialized manpower can only appoint in an organization through a good staffing system.
3. **Development of Human Capital:** Another function of staffing is concerned with human capital requirements. Since the management is required to determine in advance the manpower requirements. Therefore, it has also to train and develop the existing personnel for career advancement. This will meet the requirements of the company in the future.
4. **Optimum Utilization of Human Resources:** The wage bill of big concerns is quite high. Also, a huge amount is spent on recruitment, selection, training, and development of employees. To get the optimum output, the staffing function should be performed in an efficient manner.
5. **Reduces Cost of Production:** Staffing also plays an important role in reducing cost of production. Because it helps in appointing right person at the right job, at the right, time so that no wastage and mistakes can be made by efficient personnel during the production of products. Hence, it is clear that it assists in reducing cost of production.
6. **Effective Use of Technology and Other Resources:** What is staffing and technology's connection? Well, it is the human factor that is instrumental in the effective utilization of the latest technology, capital, material, etc. the management can ensure the right kinds of personnel by performing the staffing function.

## Benefits of Staffing:

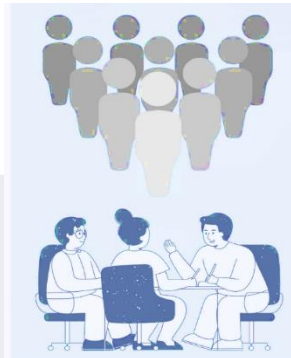
1. **Best candidate:** Staffing aids in the identification and selection of the best candidate for the job.
2. **Increases Efficiency:** It ensures that the right people are chosen for the right job, which contributes to the organization's overall efficiency and performance.
3. **Better growth opportunities:** An organization has a better chance of growing if the best candidates are chosen for the job.
4. **Manpower Planning:** Staffing aids in manpower planning and proper manpower utilization. It also aids in the filling of vacant job positions, ensuring that working efficiency is maintained.
5. **Harmony:** Through staffing the right kind of people are selected for the job, whose selection is based on merit. These people are put to work after the required background checks and provision of proper training.

## Staffing As a Part of Human Resource Management:

- Staffing function deals with human element, this plays an important role in the success of an organisation.
- As an organization grows the number of people employed increases and a separate department called the human resource department is formed which consists of specialists and experts in dealing with people.
- Human Resource Management involves procuring, developing, maintaining, and appraising competent and satisfied workforce to achieve the goals of the organization efficiently and effectively.

## Staffing process:

**Manpower Planning:** Manpower planning can be regarded as the quantitative and qualitative measurement of labour force required in an enterprise. Therefore, in an overall sense, the planning process involves the synergy in creating and evaluating the manpower inventory and as well as in developing the required talents among the employees selected for promotion advancement.



### Staffing Process

- Step 1 : **Manpower Requirements**
- Step 2 : **Recruitment**
- Step 3 : **Selection**
- Step 4 : **Orientation and Placement**
- Step 5 : **Training and Development**
- Step 6 : **Remuneration**
- Step 7 : **Performance Evaluation**
- Step 8 : **Promotion and Transfer**

1. **Recruitment:** Recruitment is a process of searching for prospective employees and stimulating them to apply for jobs in the organization. It stands for finding the source from where potential employees will be selected.
2. **Selection:** Selection is a process of eliminating those who appear unpromising. The purpose of this selection process is to determine whether a candidate is suitable for employment in the organization or not. Therefore, the main aim of the process of selection is selecting the right candidates to fill various positions in the organization. A well-planned selection procedure is of utmost importance.
3. **Placement:** Placement means putting the person on the job for which he is selected. It includes introducing the employee to his job.
4. **Training:** After selection of an employee, the important part of the programmed is to provide training to the new employee. With the various technological changes, the need for training employees is being increased to keep the employees in touch with the various new developments.
5. **Development:** A sound staffing policy provides for the introduction of a system of planned promotion in every organization. If employees are not at all having suitable opportunities for their development and promotion, they get frustrated which affect their work.
6. **Promotions:** The process of promotion implies the up gradation of an employee to a higher post involving increasing rank, prestige, and responsibilities. Generally, the promotion is linked to increment in wages and incentives but it is not essential that it always relates to that part of an organization.
7. **Transfer:** Transfer means the movement of an employee from one job to another without increment in pay, status or responsibilities. Therefore, this process of staffing needs to be evaluated on a timely basis.
8. **Appraisal:** Appraisal of employees as to how efficiently the subordinate is performing a job and also to know his aptitudes and other qualities necessary for performing the job assigned to him.
9. **Determination of Remuneration:** This is the last process which is very crucial as it involves in determining remuneration which is one of the most difficult functions of the personnel department because there are no definite or exact means to determine correct wages.

## Benefits of Staffing Process:

The benefits of an effective staffing function are as follows:

- Staffing process helps in getting right people for the right job at right time. The function of staffing helps the management to decide the number of employees needed for the organization and with what qualifications and experience.



- Staffing process helps to improved organizational productivity. Therefore, through proper selection of employees in the organization, it can increase the quality of the employees, and through proper training, the performance level of the employees can also be improved.
- It helps in providing job satisfaction to the employees and thus keeps their morale high. With proper training and development programmer, the employees get motivation, and their efficiency improves, and they feel assured of their career advancements.
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### Recruitment:

Recruitment may be defined as the process of searching for prospective employees and stimulating them to apply for jobs in an organization.

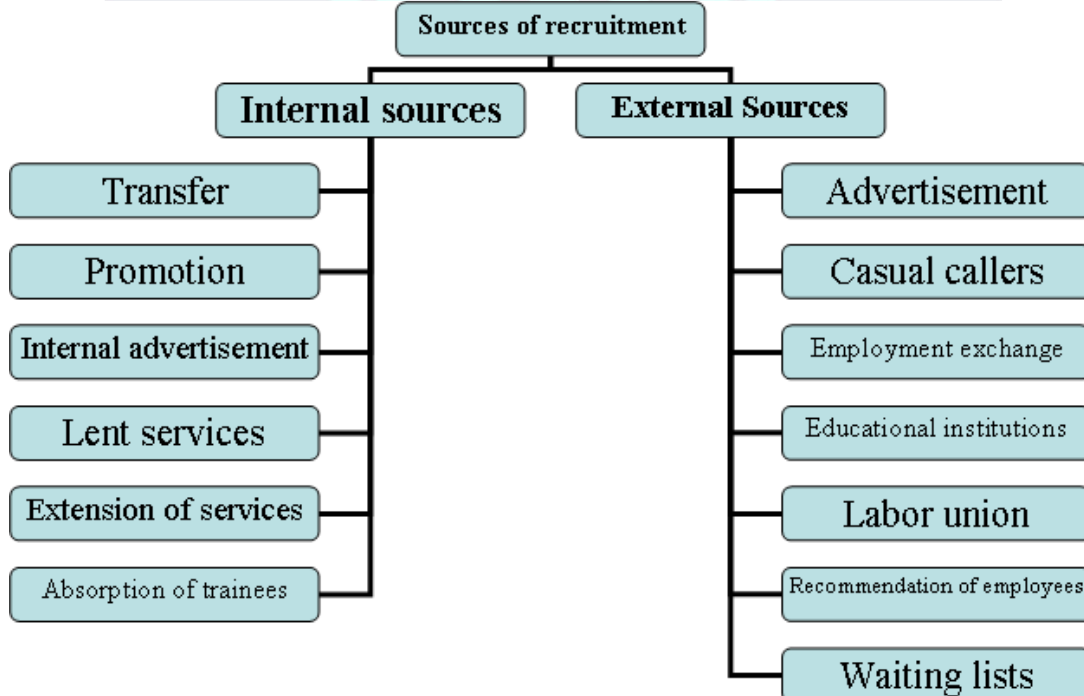
### Sources of Recruitment:

1. There are two sources of recruitment:
2. Internal
3. External



### Internal Sources:

Internal Sources of recruitment are those sources in which the talent acquisition is done from within the organization.



1. **Transfers:** Transfer involves shifting of persons from present jobs to other similar jobs. These do not involve any change in rank, responsibility or prestige. The numbers of persons do not increase with transfers.
2. **Promotion:** Promotions refer to shifting of persons to positions carrying better prestige, higher responsibilities and more pay. The higher positions falling vacant may be filled up from within the organisation. A promotion does not increase the number of persons in the organisation.



3. **Present Employees:** The present employees of a concern are informed about likely vacant positions. The employees recommend their relations or persons intimately known to them. Management is relieved of looking out prospective candidates.

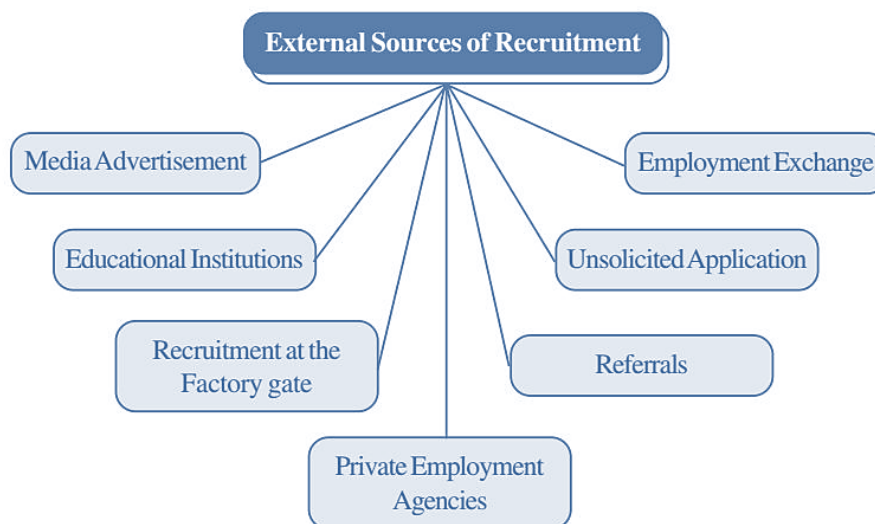
### Advantages of Internal Sources Recruitment:

1. Employees are motivated to improve their performance.
2. Internal recruitment also simplifies the process of selection & placement.
3. No wastage of time on the employee training and development.
4. Filling of jobs internally is cheaper.

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### External Sources of Recruitment:



When the candidates from outside the organization are invited to fill the vacant job position then it is known as external recruitment. The common methods of external sources of recruitments are:

1. **Direct Recruitment:** Under the direct recruitment, a notice is placed on the notice board of the enterprise specifying the details of the jobs available.
2. **Casual callers:** Many reputed business organizations keep a data base of unsolicited applicants in their office. This list can be used for Recruitment.
3. **Advertisement:** Advertisement in media is generally used when a wider choice is required. Example- Newspapers, Internet, Radio, Television etc.
4. **Employment Exchange:** Employment exchange is regarded as a good source of recruitment for unskilled and skilled operative jobs.
5. Campus recruitment and labour contractors can be used for the purpose.

### Merits of External Sources:

1. **Qualified Personnel:** By using external source of recruitment the management can attract qualified and trained people to apply for the vacant jobs in the organization.
2. **Wider Choice:** The management has a wider choice in selecting the people for employment.



3. **Fresh Talent:** It provides wider choice and brings new blood in the organization.
4. **Competitive Spirit:** If a company taps external sources, the staff will have to compete with the outsiders.

### Limitations of External Sources of Recruitment:

1. **Dissatisfaction among existing employees:** Recruitment from outside may cause dissatisfaction among the employees. They may feel that their chances of promotion are reduced.
2. **Costly process:** A lot of money has to be spent on advertisement therefore this is costly process.
3. **Lengthy Process:** It takes more time than internal sources of recruitment.

### Selection:

Selection is the process of choosing from among the candidates from within the organization or from outside, the most suitable person for the current position or for the future position.

#### 1. Process of selection:

The successive stages in selection process are:

**Preliminary Screening:** Preliminary screening helps the manager eliminate unqualified or unfit job seekers based on the information supplied in the application forms.

#### 2. Selection Tests:

These tests include:

- **Intelligence Tests:** It tests a person's ability to make decisions and adjustments.
- **Aptitude Tests:** It is a measure of individuals potential for learning new skill.
- **Personality Tests:** personality tests provide clues to a person's emotion.
- **Trade Tests:** It measures the existing skills of an individual.
- **Interest Tests:** It allows to know the Pattern of interests and involvement of a person.

#### 3. Employment Interviews:

It is an in-depth formal conversation conducted:

- To find out suitability of the candidate for a specific post.
- To seek more information about the candidate.
- To give the candidate an accurate picture of job with details of terms and conditions and to clarify his doubt.

4. **Reference Checks:** The prospective employer checks the authenticity of the references given by the applicant. They conduct a search into candidate's family background, past employment, education, police records etc.

5. **Selection Decisions:** A list of candidates who clear the tests and interviews are generally considered for the final selection based on managers opinion.

#### 6. Medical/ Physical Examination:

- A medical expert or a certified clinic appointed by organization has to certify whether the candidate is physically fit to the requirements of a specific job.
- A proper physical exam will ensure higher standard of health & physical fitness of employees thereby reducing absenteeism.

7. **Job Offer:** After selection procedure and medical examination, he/ she is formally appointed by issuing him an Appointment Letter.

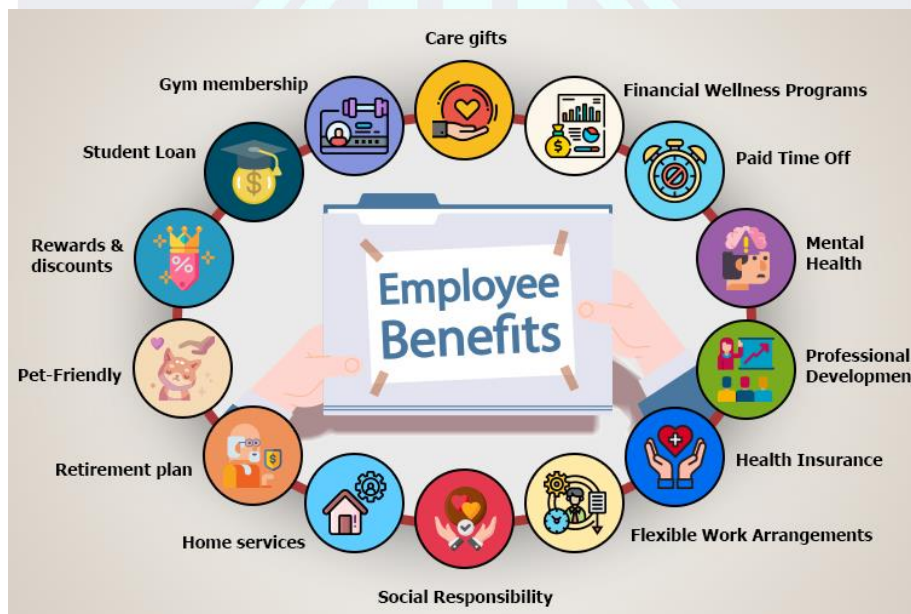
8. **Contract of Employment:** After getting the job offer, the candidate has to give his acceptance. After acceptance, both employer and employee will sign a contract of employment which contains terms & conditions, pay scale, leave rules, hours of work, mode of termination of employment etc.

### Difference between Recruitment and Selection:

Basis of difference	Recruitment	Selection
<b>Meaning</b>	The process of locating and enlisting the necessary personnel for a job is referred to as recruitment.	The process of selecting the best candidate from a pool of candidates gathered during the recruitment process is referred to as selection.
<b>Sequence</b>	Recruitment is the second stage of the staffing process.	Selection is the third stage of the staffing process, following recruitment.
<b>Employment contract</b>	The organization does not offer any employment contracts to the candidates gathered through recruitment.	The organization offers an employment contract to candidates who successfully complete the selection process, which includes information such as the date of joining, terms and conditions, and so on.
<b>Characteristic</b>	The recruitment process entails attracting as many candidates as possible for the job.	The selection process entails selecting only the best candidates and rejecting the rest.

**Training:** Training is the act of increasing the knowledge and technical skills of an employee for doing a particular job efficiently. Both existing employees and new employees get acquainted with their jobs and this increases job related skills.

### Benefits to the Employee:



- Better career opportunities:** Training helps in improving the knowledge of the employee which in turn helps in improving his career prospects.
- Earn more:** By helping the individual to improve their knowledge and skills, it improves the earning prospects of employees.
- Less accident prone:** With proper training, employees become more efficient in handling complex machines. This helps in reducing the chances of an accident.
- Self-confidence:** By increasing knowledge, skills and aptitude of employees, training helps in boosting self-confidence, which in turn helps in improving job satisfaction.



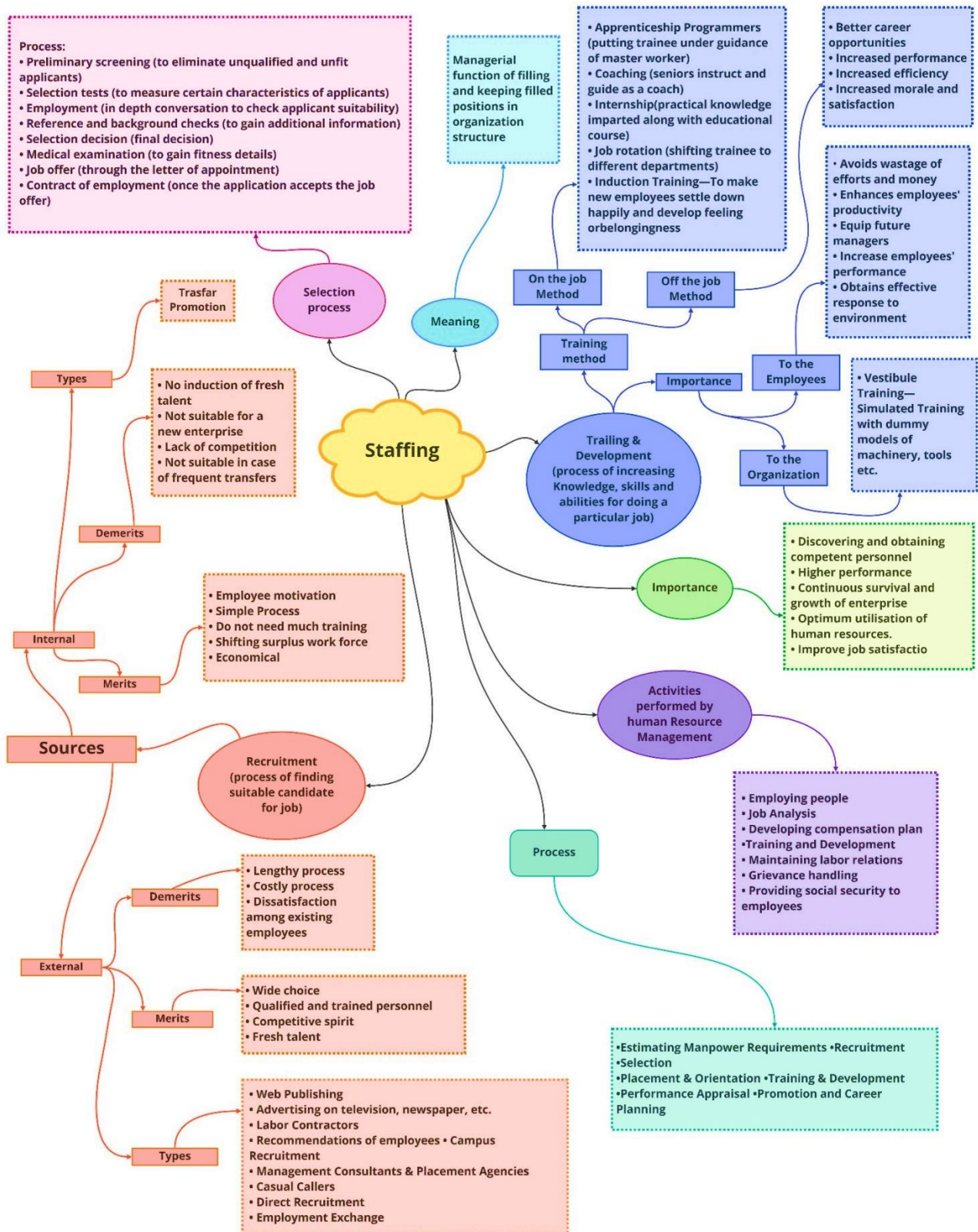
### Benefits to the Organisation:

1. **Less wastage:** With training, employees learn to work systematically without the need of any hit and trial method. This helps in reducing the wastage of time and money.
2. **Higher profits:** By developing the skills of individuals, it makes them more efficient and productive. With increase in overall productivity, the profits of the organisation rise.
3. **Managerial efficiency:** Training imparts self-confidence among employees to face new challenges. It helps them to better deal with varied situations and problems.
4. **Reduced absenteeism:** Effective training helps in boosting the morale and self-confidence of employees, which in turn helps in reducing absenteeism and employee turnover in the organisation.
5. **Adapting to changes:** Training equips the trainee to respond and adopt to the changing economic and technological environment.

### Difference Between Training and Development:

Basis of Difference	Training	Development
Meaning	Training is the process of improving an employee's skills and competence required to perform a specific job.	The process of an employee's overall growth is referred to as development.
Scope	Training is limited in scope and focuses on how to become more efficient in one's intended job.	Development is broader in scope and focuses on the employee's overall personality development. Training is a component of development.
Focus	The focus of training is on the specific job requirement, so it is job oriented.	The focus of development is on overall growth and, as a result, is career oriented.

Class : 6th Business Studies  
Chapter-6 : Staffing





## Important Questions

### Multiple Choice questions-

- Recruitment is a \_\_\_\_\_
  - Day-to-day Process
  - Negative Process
  - Positive process
  - None of the above
- Main aim of Recruitment is \_\_\_\_\_
  - To attract more and more candidates
  - To attract fewer candidates
  - To call selected candidates
  - None of the above
- Which test is helpful in assessing the individual's capacity for learning new skills?
  - Trade Test
  - Aptitude Test
  - Personality Test
  - Intelligence Test
- Under which method of training, employees are shifted from one job position to another:
  - Promotion
  - Transfer
  - Training
  - Job Rotation
- Selection is the process of \_\_\_\_\_
  - Inviting Applications
  - Identifying different sources of recruitment
  - Identifying and choosing the best candidate
  - None of the above
- Which method of training is concerned with familiarizing the new employee with the organization?
  - Induction training
  - Apprenticeship training
  - Coaching
  - Job rotation
- The main purpose of Selection is \_\_\_\_\_
  - To Select board members
  - To Select Recruiters
  - To attract more candidates
  - To Select most suitable candidate
- Lectures and Conferences are method of \_\_\_\_\_
  - Training
  - Development
  - Recruitment
  - Selection
- Staffing is very important function these days because of \_\_\_\_\_
  - Advancement of technology
  - Increasing size of organisation
  - Complicated behaviour of human beings
  - All of the above
- Recruitment is the process of \_\_\_\_\_
  - Promotion of employees
  - Training to employees
  - Performance Appraisal
  - Searching for prospective employees
- Staffing is \_\_\_\_\_ function
  - Top Level Function
  - Planning
  - Budget
  - Managerial Function
- Which of the following is not concerned with staffing?
  - Recruitment
  - Training
  - Publicity
  - Selection
- Staffing function begins with \_\_\_\_\_
  - Selection
  - Estimating manpower requirements
  - Training
  - Promotion
- Face to face conversation between employer and applicant is known as:
  - Selection
  - Orientation
  - Interview
  - Campus recruitment

15. Training is a process by which \_\_\_\_\_ of employees is increased.
- Knowledge
  - Aptitudes
  - Skills and abilities
  - All of the above

### Very Short-

- Why is induction is not required in the internal source of recruitment.
- State the meaning of placement as a staffing function.
- Name two websites which are commonly visited both by the prospective employees and the organizations searching for suitable people.
- Training and Development are one and the same thing. Do you agree?
- It is described as the managerial function of filling and keeping filled the positions in the organization structure. Which function of management is referred here?
- It is recruitment, selection, development, utilization, compensation and motivation of human resources of the organization. Give the name of the concept mentioned here.
- It implies introducing the selected employee to other employees and familiarizing him with the rules and policies of the organization. Name it.
- What is the next step after selection?
- It seeks to attract suitable applicants to apply for available jobs. Give the term.
- These are run by the Government as a source of recruitment for unskilled and skilled operative jobs. What is being referred here?

### Short Questions-

- "There is no need of human resource planning as so many people are available in the market these days." Do you agree with this statement? Give reasons.
- "The present day human resource management is a broader concept." Explain.
- Describe briefly the steps involved in the process of staffing.
- 'Internal sources of recruitment are better than external sources of recruitment.' Do you agree with this statement? Give any two reasons in support of your answer.

- What is meant by 'Selection'? Explain any five steps involved in the process of selection of employees.
- Distinguish between training and development.
- State the benefits of employee's training.
- What do you meant by 'on the job training'? Explain any three methods of 'off the job' training.
- Hamish is working as a supervisor in a company. Due to his hard work he is promoted to the post of Production Manager. Now the post of supervisor is vacant and no one can be transferred or promoted to this post. Name the source of recruitment the company will use to fill up this post. State any three advantages of using this source of recruitment. (4M)
- While selecting employees, an organization is not giving any priority to disabled candidates, weaker sections in the society and even women. Identify the values missing in the company's selection process and also suggest a remedy.

### Long Question-

- Explain in brief on the job methods of training.
- Today staffing is the activity of personnel Department/ Human Resource Management. Explain the functions of Human Resource Management?
- What is manpower planning? Explain the different steps to be taken while preparing Manpower Planning?
- Describe three off-the-job methods of training.
- Write short notes one
  - Employment Tests
  - Evolution of HRM
- What is the importance of staffing function in today's environment?

### Case Study Based Question-

- 'New range' is a chain of departmental stores in India with 56 outlets. It sells the best products at the lowest price. The Human Resource department takes care to select, train, motivate and retain the employees. Currently, it has 170 full time employees and 30 part time employees.

For top-level management, employees are recruited through private consultants. These professional recruiters can entice the needed top executives from other companies by making the



right offers. Employees appointed at the entry level are recruited through walk-in. For that, a notice is placed on the notice board specifying the details of the jobs available. 'Newrange' also encourages present employees or their friends and relatives to refer candidates. They also visit some of the reputed educational institutions to hire some of the most talented and promising students as its employees.

'New range' shifts workforce from surplus departments to those where there is shortage of staff instead of lying them off. Explain the various internal and external sources of recruitment used by 'New range' to recruit its employees.

2. A company X limited is setting up a new plant in India for manufacturing auto components. India is a highly competitive and cost effective production base in this sector. Many reputed car manufacturers source their auto components from here.

X limited is planning to capture about 40% of the market share in India and also export to the tune of at least \$5 million in about 2 years of its planned operations. To achieve these targets it requires a highly trained and motivated work force. You have been retained by the company to advise it in this matter. While giving answers keep in mind the sector the company is operating.

- a. Outline the process of staffing the company should follow.
- b. Which sources of recruitment the company should rely upon. Give reasons for your recommendation.
- c. Outline the process of selection the company should follow with reasons.
- d. Which methods of training and development should be company initiate? Explain giving reasons.

### Assertion Reason Question-

1. In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.
  - a. Assertion and reason both are correct statements and reason is correct explanation for assertion.
  - b. Assertion and reason both are correct statements but reason is not correct explanation for assertion.
  - c. Assertion is correct statement but reason is wrong statement.
  - d. Assertion is wrong statement but reason is correct statement.

**Assertion (A):** Recruitment is a positive step in the process of staffing.

**Reason (R):** Internal sources of recruitment boosts up the morale of employees.

2. In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.
  - a. Assertion and reason both are correct statements and reason is correct explanation for assertion.
  - b. Assertion and reason both are correct statements but reason is not correct explanation for assertion.
  - c. Assertion is correct statement but reason is wrong statement.
  - d. Assertion is wrong statement but reason is correct statement.

**Assertion (A):** The staffing function has assumed greater importance in the present scenario.

**Reason (R):** There has been rapid advancement of technology, increasing size of organisation and complicated behaviour of human beings.

## Answer Key

### MCQ Answers-

1. **Answer:** (c) Positive process
2. **Answer:** (a) To attract more and more candidates
3. **Answer:** (b) Aptitude Test

4. **Answer:** (d) Job Rotation
5. **Answer:** (c) Identifying and choosing the best candidate
6. **Answer:** (a) Induction training



7. **Answer:** (d) To Select the most suitable candidate
8. **Answer:** (a) Training
9. **Answer:** (d) All of the above
10. **Answer:** (d) Searching for prospective employees
11. **Answer:** (d) Managerial Function
12. **Answer:** (c) Publicity
13. **Answer:** (b) Estimating manpower requirements
14. **Answer:** (c) Interview
15. **Answer:** (d) All of the above

### Very Short Answers-

1. **Ans.** Because employees are already well familiar with the organization.
2. **Ans.** Placement: Once the job offer has been accepted by the selected candidate he placed on this new job. Proper placement of an employee reduces absenteeism Placement therefore refers to placing the right person on the right job.
3. **Ans.** a) www.naukari.com; b) www.jobstreet.com
4. **Ans.** No they are different
5. **Ans.** Staffing
6. **Ans:** Human Resource Management.
7. **Ans:** Orientation.
8. **Ans:** Placement and Orientation.
9. **Ans:** Recruitment.
10. **Ans:** Employment exchanges.

### Short Answer-

1. **Ans.** No, I don't agree with this statement. There is a great need of man power planning due to the following reasons:
  1. Organisation needs man power planning: To meet the demands of changing job requirements due to change of technology.
  2. Man power requires forecasting: Provides a basis of recruitment, transfer and training employees.
2. **Ans.** The present day human resource management includes the following activities:
  - a. Helps the organization to achieve its goals
  - b. Employees the skills and knowledge of employees efficiently and effectively.
  - c. Enhance job satisfaction.
  - d. Maintain high morale and good human relations within the organization.

3. **Ans.** Man power Planning: The organization estimate the total man power requirement by considering all the departments of the organization.

**Recruitment:** The second step after man power planning is recruitment and selection. Recruitment aims at attracting job applicants preposition in the organization.

**Selection:** Selection consists of making choice among applicants.

**Placement and Orientation:** It refers to placing the right person on the right job.

**Induction:** it is concerned with the process of introduction of a new employee to the organization.

**Training and development:** It is more accurately considered as a process of skill formation and behavioral change. Performance appraisal Promotion and career planning Compensation.

4. **Ans.** Yes, I agree with this statement.

#### Advantages:

1. It will assist in developing high moral of employees.
2. The candidates already working in the organization can be evaluated more economically as the expenditure is relatively less.

5. **Ans.** Selection is the process of carefully screening the candidates who offer themselves for appointment so as to choose the most appropriate person for the job.

#### Steps :

1. **The preliminary screening :** A brief screening interview is conducted as the first step in the selection process.
2. **Selection test:** Each candidate appears for employment test.
3. **Employment Interview:** Interview is a phase of testing on the basis of face to face interaction between the interviewer and the applicant.
4. **Reference and background checking:** Gather more information about the candidates from indirect personal sources.
5. **Selection decision:** After candidates process the tests and interview final decision for selection is made after considering the view of concerned manager.



6. **Medical Test:** The selection process is not complete without the medical test.
7. **Job offer:** Letter of appointment mentioning the date by which a candidate has to report on duty is handed over to the appointee.
8. **Contract of employment:** It includes various details such as pay, allowances, work rules etc.

6. **Ans.**

Training	Development
It is used to add skills abilities of the workers	Development involves improving the capacities and capability of the managerial personnel.
The term training is generally used to impart specific skills among operative workers	It is associated with the over all growth of the executives.
it is to enable the employee to do the job better	It is to enable the overall growth of the Employee.
It is a job oriented process	It is a carrier oriented process.

7. **Ans.** Benefits to the organization

- a) Economic operations: Trained personal will make economic and efficient use of resources.
- b) Increases productivity; It improves the quality and quantity of the production

**Benefits to the employees:**

- a) Acquisition of new skills: A trained employee acquires new skills.
- b) Higher Earnings: Trained employees can perform better and there by earn more. superiors at the actual work place.

8. **Ans:**

- A) On the job training: Learning by doing by the subordinates under the supervision of superiors at the actual work place.
- B) Methods:
  - i. **Apprenticeship Programme:** It is designed for higher levels of skills. It

ensures on the job training and is explained with classroom instruction in a particular subject.

- ii. **Coaching:** At lower levels the coaching may simply consist of trainee observing his supervisor so as to develop the basic skills necessary for operating machine.
- iii. **Internship training:** Technical institutes and business organizations jointly impart training to their members.
- iv. **Job rotation:** It is a method of training which serves the purpose of employees' development through provision of diversified training.

9. **Ans:** The Company will use external source of recruitment.

Advantages: i. Fresh talent ii. Wider choice iii. Qualified personnel

10. **Ans.**

- i. Social objectives are not followed.
- ii. Gender biased.
- iii. Inclusive employment policy is violated
- iv. Company's selection policy is not good.

Company should give equal opportunity to all the prospective candidates.

### Long Answer-

1. **Answer:** Under this method, the worker is given training at the workplace by his immediate supervisor. In other words, the worker learns in the actual work environment. It is based on the principle of learning by doing'. On-the-job training is considered to be the most effective method of training the operative personnel.

On the job training is suitable for imparting skills that can be learnt in a relatively short time. It has the chief advantage of strongly motivating the trainee to learn. It is not located in an artificial situation. It permits the trainee to learn on the equipment and in the work- environment, On-the-job training methods are relatively cheaper and less time-consuming. Another important factor in on-the-job training is that supervisor playing an important part in training subordinates.

There are four methods of on-the-job training described below -

1. **Coaching:** Under this method, the supervisor imparts job knowledge and skills to his subordinate. The emphasis in coaching or instructing the subordinate is on 'learning by doing' This method is very effective if the superior has sufficient time to provide coaching to his subordinate.
2. **Understudy:** The superior gives training to his subordinate as his understudy or assistant. The subordinate learns through experience and observation. This technique prepares the subordinate to assume the responsibilities of the superior's job in case the superior is absent or he leaves the organisation.
3. **Job Rotation:** The trainee is systematically transferred from one job to another so that he may get the experience of different jobs. This will broaden his horizon and capacity to do a variety of jobs. Rotation of an employee from one job to another should not be done frequently. He should be allowed to stay on a job for a sufficient period so that he may acquire the full knowledge of the job.
4. Vestibule training is adapted to the same work environment as prevails at the actual work-place in the factory. Vestibule training is suitable where a number of persons are to be trained at the same time for the same kind of work. A vestibule training workshop may be set up by an industrial organisation when it is not possible to give training to the employees at the work-place. The training job is entrusted to – the qualified instructors. The main emphasis is on learning rather than on production.

Vestibule training is an attempt to duplicate as nearly as possible the actual conditions of the work-place. The learning conditions are carefully controlled. The trainees can concentrate on training because they are not

under any pressure of work. Their activities do not interfere with the regular process of production. Thus vestibule training is very suitable where a large number of persons are to be trained and where mistakes are likely to occur which will disturb the production schedules.

2. **Answer:** Creation of Human Resource or Personnel Department: Staffing' is the responsibility of every manager. However, in not organisation, personnel or Human Resource Department is set up under the charge of Personnel or Human Resource Manager. The personnel department serves as a service department. It performs various personnel functions assigned to it by the other departments. The Personnel Manager enjoys the status of a specialist in personnel matters. Normally, persons with post-graduate qualifications in Human Resource Management, Personnel Management and Industrial Relations are preferred for this post.

The establishment of the Personnel Department does not relieve the line managers of the staffing responsibilities. In fact, the staffing function is an inherent part of the job of every manager. The Personnel Manager is appointed to provide expert assistance to them in the performance of their staffing functions of manpower planning, employment, placement, induction, training and performance appraisal. Besides these functions, the personnel department is also responsible for motivation. Working conditions, human relations and personnel records. We shall study these functions under the heading of operative Functions or Responsibilities.

Functions of Human Resources Management.

There are two sets of functions of human resources management. These include

1. Managerial functions
  2. Operative functions
1. **Managerial Functions:** The Human resources or Personnel Manager is a part of the management. So he performs the basic managerial functions of planning, organising, directing and controlling in relation to his department Like any other manager, the Personnel Manager performs all the managerial functions.



2. **Operative Functions or Responsibilities:**

The operative functions are the specific responsibilities which are entrusted to the personnel department under the supervision of the Human Resource Manager. There are concerned with, employment, training, development, compensation, integration and maintenance of personnel of the organisation.

A brief description of the basic responsibilities or functions of the Personnel Manager is given below –

1. **Employment of Personnel:** The first major responsibility of the Personnel Manager is the employment for proper kinds and a number of persons necessary to do various jobs in the Organisation. It involves .manpower, planning, recruitment, selection, placement etc. of the personnel.

Manpower planning helps to determine the manpower requirements for various departments. Recruitment is concerned with the sources of supply of work force, whereas selection involves a number of steps to employ the right type of people for various jobs. The selected employees are placed in the jobs for which they are better suited.

2. **Training and Development:** After placing the people on various jobs, personnel management is concerned with imparting them training to do their work efficiently. Proper development of Personnel is essential to increase their skills in the performance of their jobs. The personnel department designs and runs the appropriate training programmes for developing the necessary skills among the personnel.

3. **Compensation:** This function is concerned with the determination of adequate .and fair remuneration of the people for their work. The employees can be compensated both in terms of monetary as well as non-monetary rewards. Factors which must be borne in mind while fixing the compensation or remuneration of personnel are their

basic need, requirements of jobs, legal provisions regarding minimum wages, the capacity of the organisation to pay, wage level afforded by the competitors etc. For fixing the wage levels, the Personnel Manager can also make use of techniques like job evaluation, performance rating etc.

4. **Motivation of Workforce:** Employees work in the Organisation for the satisfaction of their needs. In many cases, it is found that they do not contribute towards the organisational goals as much as they can. This happens because employees are not adequately motivated. The personnel Manager helps the various department managers to devise a system of financial and non-financial rewards to motivate the employees.

5. **Maintainance of Good Working Conditions:** The employees must be provided with good working conditions so that they like their work and workplace and maintain their efficiency. Working conditions influence the motivation and morale of the employees. These include the measures taken for the health, safety and comfort of the working force. The personnel department also provides for various welfare services which relate to the physical and social well-being of the employees. These may include the provision of the cafeteria, restrooms, counselling, group insurance, education of children of employees, recreational facilities etc.

6. **Achieving Good Human Relations:** The personnel Manager must provide an efficient system of communication to ensure the two-way exchange of information. Many time industrial disputes occur because of poor communication. The personnel manager should always keep himself in contact with, the trade union leaders to understand their grievances and attempt to remove them so that harmony is maintained in the organisation,

7. **Personnel Records:** It is the duty of the personnel department to maintain records of the employees working in the enterprise. It keeps full records about their training, achievement, transfer, promotion etc. It preserves many other records relating to the behaviour of personnel like absenteeism and labour turnover and personnel programmes and policies of the organisation. It also maintains various records and registers as required by the Factories Act, the employees state Insurance Act and other Labour Laws.
3. **Answer:** Manpower planning or human resource planning is the process of determining scientifically the number and type of employees that an enterprise will need in a specified period of time in future. Its purpose is to ensure that the organisation will have an adequate number of qualified persons at the proper time to perform various jobs efficiently and with personal satisfaction. Manpower planning consists of the following steps
    1. **Forecasting Manpower Needs:** First of all number and type of personnel required are anticipated. The number of employees required in a future period can be estimated by keeping in mind the expected workload. Workload depends upon the production and sales budgets, expansion plans etc. of the company. The type of employees required is estimated by keeping in view the requirements of job vacancies to be filled. Job requirements can be determined by analysing jobs. Job analysis is a thorough analysis of the job to identify the knowledge, skills and experience required for effective performance.
    2. **Preparing Manpower Inventory:** A detailed list of existing manpower is prepared. Then the number and quantity of existing staff are assessed to determine the extent to which manpower forecast can be met from within the organisation. The qualifications, experience, aptitude etc. Of every employee are analysed. Such an inventory of existing manpower is called manpower inventory or manpower audit.

Manpower inventory will give an idea as to how far the future requirements of manpower can be met from within the organisation. It will reveal the adequacy of manpower in terms of number and skills. Absenteeism and labour turnover and such other manpower problems are also anticipated. A comparison between manpower for cast and manpower inventory will reveal gaps in manpower to be filled in form outside.

3. **Formulating Manpower Programmes:** Detailed programmes are prepared for recruitment, selection, training, transfer and promotion of employees so as to meet future manpower needs, The first step in the staffing process is the estimation of manpower requirements. It is known as human resource planning or manpower planning. Under it the number and kind of personnel required by the organisation during a specified future period (e.g. one year) are determined. Then the number and type of existing personnel are assessed.

This indicates the extent to which the future manpower needs can be met from within the organisation. It also gives an idea as to how far it is necessary to recruit people from outside. Finally, programmes are formulated to recruit, select and train the required staff over the planning period.

The objectives of estimating staff requirements are to ensure that the organisation has adequate number and quality of employees to fill in the various positions. It is useful in many ways. It continuously provides the personnel required at various levels in the organisation. It enables the organisation to make full use of its resources. The organisation can meet its changing manpower needs without any problem. It is also in a position to fill in vacancies arising from the retirement of its senior managers.

While estimating man-power requirements, the managers should consider several factors which is as follows:

- (a) Plans of the organisation concerning products services, expansion of operations etc:



- (b) Nature and size of the organisation including the degree of decentralisation, a span of control staff units, departmentation etc.
- (c) Type of technology to be adopted i.e. a degree of mechanisation and automation.
- (d) Retirement schedule of the existing staff.
- (e) Number of employees who may leave the organisation.
- (f) The Average number of personnel absent from the job.

Systematic manpower planning necessary due to the following reasons:

- (a) **Future man-power needs:** Future manpower needs cannot be determined without systematic manpower planning. With the help of manpower planning, an organisation can secure the services of the right type of people at the right time.
- (b) **Scarce talent:** Modern organisations require highly specialised technicians and professionals. There is a scarcity of such talent. Manpower planning helps in ensuring an adequate supply of skilled personnel for an organisation. ,
- (c) **Coping with changes:** Changes in technology, products, marketing conditions etc. require changes in job content, skill requirements, kind of people etc. Manpower planning helps in avoiding a shortage of manpower in some areas and surplus in other areas.
- (d) **Growth and expansion:** Manpower planning is necessary for ensuring replacements from time to time due to retirement and death of existing employees. Moreover, an organisation can properly meet its manpower requirements arising out of expansion and growth schemes. Manpower planning helps in optimum utilisation of manpower and in minimising the cost of labour. Workers who become redundant due to automation can be absorbed in new jobs after some

training. This helps to improve industrial.

4. **Answer:** Off-the-job Training: Off-the-job training as the name itself indicates, refers to training conducted away from the actual work setting. There may be a special site in the organization itself or in a non-organizational location elsewhere (for example, vocational school or university). Off-the-job training is particularly useful and appropriate for certain managerial skills such as interpersonal abilities and also for certain production jobs where machinery is employed to control the pace of work-an example may be the assembly-line operation and is also useful for some technical jobs where teaching expertise is found elsewhere.

Some of the common methods of off-the-job training include lectures, conferences, group discussions, role-playing, case studies, programmed instruction, and T. group training.

(a) **Lectures and classroom instruction:**

Classroom training is conducted off the job and is probably the most familiar method. It is an effective means of imparting the information and knowledge quickly to a large chunk of members „ with limited knowledge or no knowledge of the subjects being taught. Lecturing is particularly useful for teaching the factual material, concepts, principles, theories and their application to job situations.

In general, classroom instructions are more frequently used for technical, professional and managerial employees. These ‘ lectures are formally organized talks by the training specialists themselves. Lecturing is an effective method and is interesting especially when able lecturers are employed to impart the knowledge – technical or otherwise. But the disadvantages of lecturing include:

1. the learners may be passive instead of active.
2. there is no feedback from the audience regarding their lecturers.
3. a clear and vigorous presentation on the part of the lecturer requires a great deal of preparation
4. the untrained and inexperienced lecturer may deliver an unpalatable

lecture, he might rumble of pack too much redundant „ information in a single lecture leaving the important technical details.

5. lecturing emphasizes the routine memorization of facts rather than the practical aspects of a job. However, the lecture method in training is useful to introduce the subject matter its overview, its principles, laws, classification, and summaries etc. to the listeners. Because of its simplicity and efficiency in imparting knowledge, the lecture method is still alive in work organizations.

- (b) **The conference method:** Instead of indulging in straight lecturing, some organizations prefer to hold conferences where participants are required to pool their ideas, viewpoints, suggestions and discuss them at conferences. Conferences provide a common plate form for intensive and through group discussion and result in suggesting the improved methods of performing work in the organization.

The conference allows the trainee to look at the problem from a broad angle allow him to analyse it more carefully and arrive at conclusion. Conference method is ideal for analysing problems and issues concerning organizations and their members' conferences reduce the dogmatism and promote understanding between members. Upon close and intensive discussions, members will be willing to accept change, if any for the betterment of the organization. Conferences method has several limitations such as:

1. it is limited to a small group of people ranging from fifteen to twenty-five.
2. progress of learning is slow because all the members have ' full freedom to speak and in the curiosity of participation some. members may come out with totally irrelevant issues, and
3. some members may feel that the whole conference is useless unless they are made aware of the objectives of holding the conference.

- (c) **Group discussion:** Also known as team discussion, or seminar in the group discussion the members are requested to present papers and discuss the papers in a common platform. The trainees are allowed to read their respective papers and this is followed by a thorough critical discussion. While preparing the paper, the trainee has free access to files concerning the subject and compile the information.

After consulting the necessary files the trainees may discuss the ramifications and complexities of a particular job or work and suggest solutions for the probable problems the trainees are likely to encounter in near future.

- (d) **Roleplaying:** The role-playing goes by a variety of names, such as psychodrama. role-reversal, social-drama, and soon. Role-playing involves the spontaneous acting out of a situation by two or more people under the specific direction of a trainer. The notable characteristic of role-playing is that dialogue usually ensues and the trainees are enthusiastic, playing out their roles.

In role-playing, trainees act out a given role as they would be performing in a stage play. The role players are informed only about the situation and of the role they are expected to play. Role-playing primarily involves hiring, firing, discussions about the grievance procedures employed, employer-employee relationships. The primary advantages of role-playing include

1. development of leadership skills and decision-making skills of the entire group.
2. trainees learn the importance of participation in bringing about the acceptance of resource allocation decisions.
3. human interaction and sensitivity are emphasized in role-playing and
4. it brings desired changes in employee attitudes and behaviour. However, role-playing can be very time consuming and without competent leadership, it could be a waste of time.



- (e) **Case studies:** Another sophisticated off-the-job- training is through case studies. The case study is based on the firm belief that managerial competence can best be attained through the study contemplation and discussion of concrete cases. The trainees are given the cases and are asked to identify the basic problem and suggest solutions. The case study is primarily useful for supervisory personnel and serves as a useful technique for developing decision-making and problem-analysing skills to the middle managers.
- (f) **Programmed instruction:** Programmed instruction involves breaking, information into meaningful units and rearranging them in a proper sequence to form a learning package. Programmed learning consists of three functions:
1. presenting questions, facts or problems to the learner.
  2. allowing the trainee to respond and
  3. providing the necessary feedback on the accuracy of his answers. Programmed instruction makes use of books or manuals but normally it is supported by electronic teaching machines, computer systems. In practice, the trainee reads a particular set of materials and then responds to questions usually multiple-choice questions or true-false type questions. If the answer is correct the trainee proceeds to answer the next question. However, if the answer is incorrect the trainee is furnished additional information and is required to respond to questions on that material. This procedure is repeated until the trainee has answered correctly. Programmed instruction method is appreciated because it incorporates several learning techniques including movement from simple to complex material and provision of feedback. Research reveals that programmed instruction is one of the more effective methods for building knowledge and retention of that knowledge.

- (g) **T-group training:** Also frequently known as sensitivity training T-group training is a process in which several individuals work together for several days for the purpose of building self-awareness, understanding of group processes and a greater understanding of interpersonal relationships. The trainees are encouraged to portray their feelings, abilities and needs in building interpersonal relationships.

The basic purpose of sensitivity training to increase the participant's insight into his own behaviour and the behaviour of others by encouraging an open expression of feelings in the trainer-guided T group laboratory.

#### 5. Answer:

1. **Employment Tests:** An employment test is a mechanism (either a paper and pencil test or an exercise) that attempts to measure certain characteristics of individuals. These characteristics range from aptitudes, such as manual dexterity, to intelligence to personality.

Important tests used for selection of employees:

- (a) **Intelligence Tests:** This is one of the important psychological tests used to measure the level of intelligence quotient of an individual. It is an indicator of a person's learning ability or the ability to make decisions and judgements.
- (b) **Aptitude Test:** It is a measure of individuals potential for learning new skills. It indicates the person's capacity to develop. Such tests are good indices of a person's future success score.
- (c) **Personality Tests:** Personality tests provide clues to a person's emotions, his reactions, maturity and value system etc. These tests provide an overall personality. Hence these are difficult to design and implement.
- (d) **Trade Test:** These tests measure the existing skills of the individual. They measure the level of knowledge and proficiency in the area of professions or technical training. The difference between aptitude test and trade test is



that the former measures the potential to acquire skills and the later the actual skills possessed.

2. **Evolution of HRM:** Human Resource Management has replaced the traditional concept of labour welfare and personnel management. HRM in its – present form has evolved from a number of significant inter-related developments, which date back to the era of industrial revolution emergence of trade union movement lead to the need of a person who could act as an effective line between the owners and workers.

Thus the concept of labour welfare officer came into the being.

His role was limited to the bare minimum welfare activities of employees. In fact, he was looked down by both the workers and the owners.

With the introduction of the factory system, thousands of persons began to be employed under one roof. The job of hiring people for the organisation was given to one man, who later on was assigned the responsibility of recruitment, selection and placement of personnel.

This led to the emergence of a personnel officer in the first place and personnel manager, later on.

Human relations approach recognizes the human factor as the most important instrument of success in the organisation. Fast-changing technological developments, how our, necessitated new skills development and training of employees. People came to be recognized as a valuable resource, which can be further developed. Increase in the scope of the work led to the replacement of personnel manager to the human resource manager. Hence HRM came to mainstream activity due to the failure of the earlier concepts to promote the potential benefit of effective management of the people.

6. **Answer:**

**Importance of staffing:** Human resources are the foundation of any business. The right people can help you take your business to the top: the wrong people can break your business. Hence staffing

function has assured greater " importance their days because of the rapid advancement of technology, increasing the size of the organization and complicated behaviour of human beings. Human resources are the most important asset of an organisation.

The ability of an organisation to achieve its goals depends upon the quality of its human resources. Therefore, staffing is a very important managerial function. No organisation can be successful unless it can fill and keep filled the various positions provided for in the structure with the right kind of people.

Proper staffing ensures the following benefits to the organisation:

1. helps in discovering and obtaining competent personnel for various jobs;
2. makes for higher performance, by putting the right person on the right job;
3. ensures the continued survival and growth of the enterprise through the succession planning for managers;
4. helps to ensure optimum utilization of human resources.

By avoiding overmanning, it prevents updo utilisation of personnel and high labour costs. At the same time, it avoids disruption of work by indicating in advance the shortage of personnel; and improves job satisfaction and morale of employees through objective assessment and fair rewarding of their contribution. Staffing function must be performed efficiently by all organisation. If the right kind of employees is not available, it will lead to wastages of materials, time, efforts, resulting in lower productivity and poor quality of products.

The enterprise will not be able to sell its products profitably. It is therefore essential that the right kind of people must be available in the right number at the right time. They should be given adequate training so that wastage is minimum: They must also be induced to show higher productivity and quality by offering them. proper incentives.

**Staffing and Human Resource Management (HRM):** The affiances and effectiveness of an organization in achieving its goals are determined to a great extent on the competence, motivation



and general effectiveness of its human resources. Managing the human component or an organisation is the most important task because the performance of the organization depends upon how well this function " is performed. Human resource management is that part of management process which develops and manages the human element of the enterprise considering their resourcefulness in terms of total knowledge, skills, creative abilities, talents, aptitudes and potential for effectively contributing to the organizational objectives.

Human Resources Management is concerned with all aspects of managing the human resources of an organization. More specifically, human resource management involves determining the organization's need of human resources, recruiting and selecting the best available employees, developing counselling and rewarding employees, acting as a liaison with unions and government organizations and handling matters related to the well being of employees. Each of these functions is necessary to some degree irrespective of type and size of the organization.

### Case Study Answer-

#### 1. Answer:

The various sources of recruitment used by 'Newgrange' to recruit its employees are:

- **Transfer:** It implies shifting an employee from one job to another. Generally, transfer does not involve any change in the responsibilities, ranks, rate of compensation or prestige of employees. For example, Rohan, working in Department A as a computer operator, is transferred to Department B on the same post in the office.
- **Placement agencies and Management Consultants:** The major difference between the public and private employment agencies is of their image. The private agencies are believed to offer positions and applicants of a higher type. Placement agencies provide a nationwide service in matching personnel demand and supply. These services compile bio data of a large number of candidates and recommend suitable names to their clients. They also charge fee for their services.
- **Direct recruitment:** A notice is placed on the

notice board of the enterprise specifying the details of the jobs available. It is followed usually for casual vacancies of unskilled or semi-skilled jobs. Job seekers assemble outside the premises of the organization on the specified date and selection is done on the spot.

- **Recommendation of employees:** Friends, relatives of current employees are also a good source from which employees may be drawn. Such a recommendation reflects on the recommender and when someone's reputation is at stake, we can expect the recommendation to be based on reliable beliefs. Employee's reference tends to be more acceptable.
- **Campus recruitment:** Recruitment from educational institutions is a well-established practice of businesses. Many big organisations maintain a close liaison with the universities, vocational schools and management institutes to recruit qualified personnel for various jobs.

#### 2. Answer:

- a. The process of staffing that the company should follow is as follows.
  - Identify and estimate the number and the kind of personnel required for the set up.
  - Look for suitable candidates to fill the job vacancies and persuade them to apply for the same.
  - Choose the right candidate through a rigorous selection process.
  - Make the selected employees comfortable and familiar with the working environment.
  - Train the employees as per the requirements of the job.
  - Assess the performance of the employees against the predetermined standards and provide feedback.
  - Place the employees who are doing well at higher level in the hierarchy and position.
  - Provide suitable compensation to the employees.

- b. The company should rely upon external sources of recruitment. As the company is setting up a new plant in a new region, candidates from the local area would be more suitable as they would be familiar with the working conditions, problems faced, etc. in the local region. This would be in favor of the organisation.
- c. The following selection process would be used.
- As a first step screen the candidates and eliminate those who do not fulfil the basic criteria and qualifications as per the job requirements.
  - Judge the candidate on different criteria such as aptitude test, intelligence test and personality test.
  - Conduct a personal interview involving a direct conversation between the manager and the candidate which would further help in judging the overall suitability of the employee according to the job requirement.
  - Conduct a background check of the candidate taking references from person known to the candidate, previous employers, etc.
  - If the candidate is found suitable provide a job offer confirming that he/she has been selected.
  - Finally provide an employment contract mentioning the terms and conditions of the employment.
  - In order to have a highly trained and motivated work force, the company must initiate the following methods of training and development.
- **Apprenticeship Programmers:** The trainees are put under master workers who guide them in acquiring the level of skills required for their jobs. These trainees or apprentices work under the trainers for a pre-defined amount of time. In the initial period, they observe the master worker performing a task and then gradually do the task themselves under the supervision of the master worker.
  - **Coaching:** In this method, the trainees are put under the guidance of a coach or a counsellor, and they work towards achieving the goals that are set on the basis of a mutual understanding. Typically, coaching aims at training the employee such that he or she can reach a higher position at work.
  - **Internship training:** Educational institutions enter into collaborations with business corporations, and some students are selected to work as interns with the corporations for a specific period.
  - **Vestibule training:** Dummy models of real working environment are created in classrooms outside the workplace. The trainees are made to work on the dummy machines and equipment, and only when they acquire adequate expertise in their use are they shifted to the actual workplace.

### Assertion Reason Answer-

1. b. Assertion and reason both are correct statements but reason is not correct explanation for assertion.
2. a. Assertion and reason both are correct statements and reason is correct explanation for assertion.





# Directing | 7

## Directing Meaning:

Directing is the process in which a superior provides instructions, guidance, and counselling to its subordinate so as to motivate and lead them for the successful achievement of objectives.

***Directing is a key managerial function***



## Characteristics of Directing:

### CHARACTERISTIC OF DIRECTING

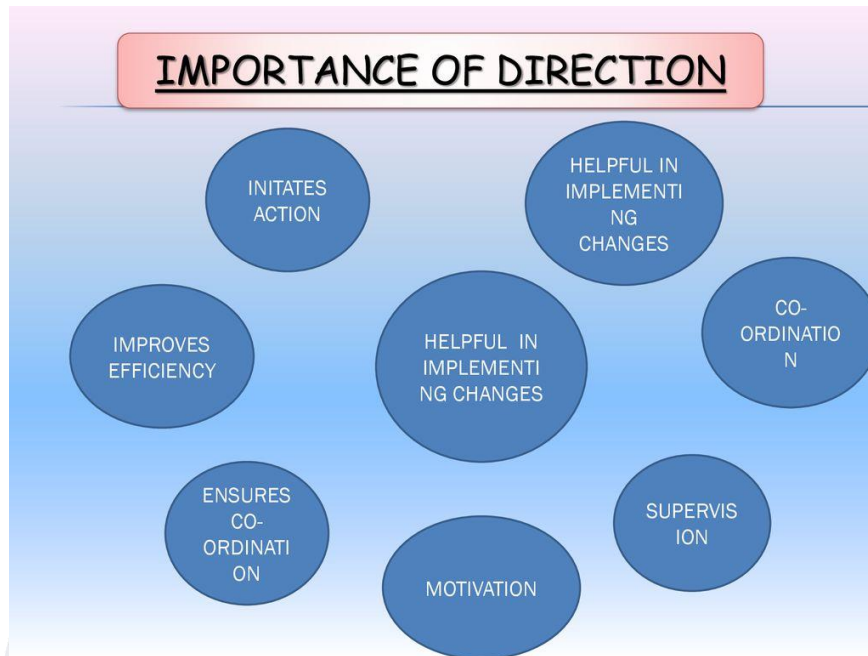


1. Directing Initiates Action
2. Directing Takes Place at Every Level of Management
3. Directing is a Continuous Process
4. Directing Flows from Top to Bottom

1. **Directing Initiates Action:** Directing is required at all stages, a manager has to perform this function along with planning, organizing, staffing and controlling.
2. **Directing Takes Place at all Levels of Management:** every manager has to perform this function and thence it takes place at all levels of management.
3. **Directing is a Continuous Process:** Directing takes place at all levels of the organisation so that all activities are directed towards the achievement of organizational goals.

4. **Directing Flows from Top to Bottom:** Directing initiates at top level and flows to the bottom of organisation through organizational hierarchy.
5. **All pervasive:** Directing takes place in every organization, and at every level of management.

### Importance of Directing:



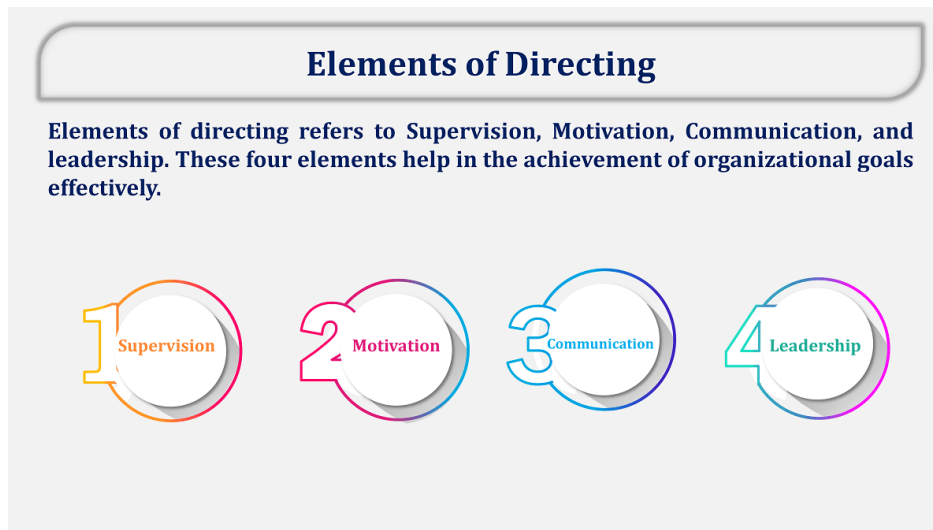
1. **Initiates action:** Directing helps to initiate action towards attainment of desired objective.
2. **Integrates efforts:** It integrates individual efforts as group effort to achieve organizational objectives.
3. **Provide leadership and motivation:** Directing motivates and provides effective leadership to employees to realise their full potential.
4. **Brings changes:** Directing introduces changes in the organization through proper communication, motivation and leadership.
5. **Maintain stability:** Balance and stability in the organization could be maintained through effective directing.

### Principles of Directing:

1. **Maximum individual Contribution:** According to this principle directing technique must help every individual in the organisation to contribute to his maximum potential for achievement of organisational objectives.
2. **Harmony of objectives:** According to this principle, there must be full harmony between organisational objectives and individual objectives. Good directing may balance between both objectives.
3. **Use of informal organisation:** According to this principle, there must be a free flow of information between the seniors and the subordinates and success of direction depends upon effective exchange of information to a great extent.
4. **Leadership:** According to this principle, while directing the subordinates, managers should exercise good leadership as it can influence the subordinates positively without causing dissatisfaction among them.
5. **Follow through:** According to this principle, it must be monitored by management as to what extent the policies framed and issued directions have been enforced.



## Elements of Directing:



1. **Supervision:** Implies overseeing the work of subordinates by their superiors. It is an act of watching & directing worker's activities.

### Importance of Supervision:

- Supervisor maintains friendly relationships with workers.
- Connects management plans and ideas to workers and represents workers grievances and problems to management.
- Helps to maintain unity amongst workers.

2. **Motivation:** It means the process of making subordinates to act in a desired manner to achieve certain organisational goals.

### Features of Motivation:

1. Motivation is an internal feeling.
2. Motivation produces goal directed behaviour.
3. Motivation can be either positive or negative.
4. Motivation is a complex process as the individuals are heterogeneous in their expectations, perceptions, and reactions.
5. **Motivation process:** Motivation process is based on human needs.

### Importance of motivation:

1. **Improves Performance:** It satisfies employee's needs resulting in higher level of performance contributing towards organizational goals.
2. **Develops a positive attitude:** Motivation techniques eliminate negativity and create a desire to realize maximum potential.
3. **Reduces employee turnover:** A satisfied employee prefers to remain loyal to the organization leading to a lesser number of people quitting the organization.
4. **Reduces absenteeism:** Motivation helps to make the workplace a source of pleasure and provides the workers with a pleasant experience resulting in increased level of commitment from employees towards work.
5. **Brings change smoothly:** A motivated staff accepts changes with much lesser resistance.

## Leadership:



Leadership is the process of influencing the behaviour of people by making them strive voluntarily towards achievement of organisational goals.

### Features of leadership:

1. Leadership indicates ability of an individual to influence others.
2. Leadership tries to bring change in the behaviour of others.
3. Leadership indicates interpersonal relations between leaders and followers.
4. Leadership is exercised to achieve common goals of the organisation.

### Importance of leadership:

1. Leadership influences the behaviour of people and makes them to positively contribute their energies for the benefit of the organisation.
2. A leader maintains personal relations and helps followers in fulfilling their needs.
3. A leader can solve every type of conflict effectively under the weight of his influence.
4. Leader provides training to their subordinates.

### Qualities of a Good Leader

1. **Physical features:** Should be fit and presentable with positive energy.
2. **Knowledge:** Should have required knowledge and competence.
3. **Integrity:** Must possess a high level of integrity and honesty.
4. **Initiative:** Should grab opportunity and use it to the advantage of organization.
5. **Communication skills:** Must possess skill to communicate and convince people effectively.
6. **Motivation skills:** Should motivate the individuals to improve their performance.
7. **Self-confidence:** Should have a high level of confidence to handle difficult situations.
8. **Communications:** is the process of passing information, experience, opinion etc. from one person to another.

### Elements of Communication Process:

1. **Sender:** The person who conveys his thoughts or ideas.
2. **Message:** Content intended to be communicated.
3. **Encoding:** Process of converting message into communication.



4. **Media:** Path through which an encoded message is transmitted to the receiver.
5. **Decoding:** It is the process of converting the encoded message in a readable format.
6. **Receiver:** The person who receives a communication message from the sender.
7. **Feedback:** It refers to the information or suggestions provided by the receiver to the sender in context to the communication or message he received.
8. **Noise:** The hindrances and obstruction to communication.

### Importance of Communication:

1. **Basis of coordination:** Acts as a basis to coordinate their efforts of employees by explaining organizational goals.
2. **Smooth working of an enterprise:** It makes interaction among all individuals possible helping smooth and unrestricted working of an enterprise.
3. **Basis of decision making:** Communication acts as a medium for providing information needed for decision making.
4. **Increases managerial efficiency:** Helps managers to convey important information to subordinates to enable them to perform with efficiency.
5. **Cooperation and industrial peace:** The two-way communication promotes cooperation and mutual understanding between the management and workers.

### Formal and Informal communication:

**Formal communication:** Formal communication flows through official channels designed in the organisation chart. There is a two-way information flow between the superior and subordinates. The communications may be oral or written

The pattern through which communication flows within the organisation is called as communication network.

### Some of the popular communication networks are:

1. **Single chain:** Single chain in this communication exists between a supervisor and his subordinates.
2. **Wheel:** In wheel network, all subordinates under one superior communicate through him only as he acts as a hub of the wheel.
3. **Circular:** The communication moves in a circle.
4. **Free flow:** Free flow of communication with each and every one in an organisation.
5. **Inverted V:** A subordinate is allowed to communicate with his immediate superior as well as his superiors superior.

### Informal Communication:

It refers to the communication within an organisation that is not officially sanctioned. This communication is based on informal relations like friendship, membership of the same club, etc.

### Advantage of informal communication:

1. Fast and effective communication.
2. Free environment.
3. Satisfying the social needs of the workers.
4. Easy solution of the difficult problems.

### Limitations of informal communication:

1. It is difficult to detect the source of such communication.
2. It also leads to generate rumours which are not authentic.
3. People's work may also affect due to informal discussion.



### Difference between Formal and Informal Communication:

Basis	Formal Communication	Informal communication
1. Meaning	Follows the official chain of command.	Between individuals and groups are not officially recognized.
2. Channel	Through a definite path.	No definite path.
3. Speed	Slow: because all information has to pass through an established scalar chain.	Very fast-Cuts across all the official channels.
4. Nature	More rigid and cannot be modified.	Flexible and varies from individual to individual.
5. Expression	It is mostly expressed in the written form.	It mostly tends to be oral.

### Barriers to Communication:

A. **Semantic Barriers:** Problems and obstructions in the encoding and decoding of messages into words or impressions.

**Reasons of semantic barriers are:**

1. **Badly expressed message:** It involves the message with inadequate vocabulary, use of wrong words, omission of important words, or framing the message improperly, etc., that may distort the understanding and readability of the message.
2. **Symbols with different meanings:** Words with multiple meanings may change the intended meaning of the message, such as idol and idle, the word value having two meanings (price and importance), deer and dear.
3. **Faulty translations:** Incorrect translations may change the meaning of the message. For example, the meaning of certain words may change in a translation of an instruction from English to Hindi.
4. **Unclear assumptions:** Sender and receiver may follow different assumptions while understanding the message resulting in different understanding of the message.
5. **Technical jargon:** Meaning of a message may not be clear if technical words are used in the communication with the workers who may not be familiar. For example the word drawings have separate meanings for a commerce person and a person from non-commerce background.
6. **Body language and gesture decoding:** Mismatch between body movement or gestures may convey wrong meaning. As in your face expression reveals anger, while your hand movements reveal otherwise.

B. **Psychological Barriers:** Sender or receiver's state of mind may influence the meaning of the message.

**Reasons of psychological barriers are:**

1. **Premature evaluation:** judgement before listening leads to misunderstanding.
2. **Lack of attention:** poor listening due to preoccupied mind of the receiver may disappoint the sender.
3. **Loss by transmission and poor retention:** When oral communication passes through various channels of communication, it destroys the structure of the message or leads to transmission of inaccurate message.
4. **Distrust:** If the parties do not believe each other, they cannot understand each other's message in its original sense.

C. **Organizational Barriers:** Organizational authority relationships, rules and regulations, may result in communication barriers.

**Reasons of organizational barriers are:**

1. **Organizational policy:** Policies may not support free flow of communication.
  2. **Rules and regulations:** Strict rules and regulations may result in delay of information, such as following a certain path for communication etc.
  3. **Status:** A status conscious manager, hampering the effectiveness of communication between him and his subordinates.
  4. **Complexity in organizational structure:** organization with too many levels may result in delay or distort of communication due to several filter points.
  5. **Organizational facilities:** Improper facilities may affect free flow of communication and may create problems.
- D. **Personal Barriers:** Personal factors of both superior and subordinate may influence an effective communication.

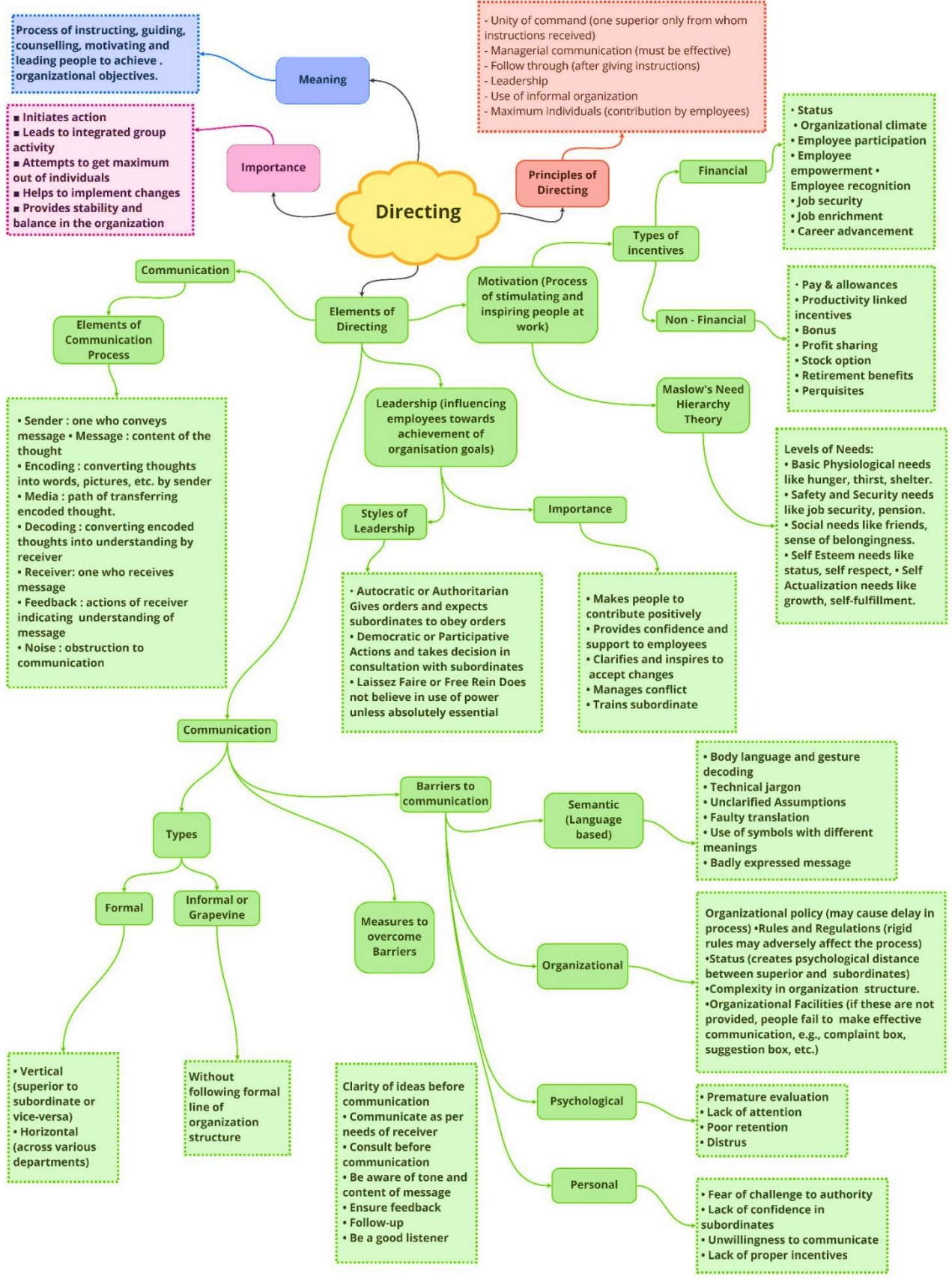
Some of the personal barriers of superiors and subordinates are given below:

1. Fear of challenge to authority.
2. Lack of confidence of superior on his subordinate.
3. Unwillingness to communicate.
4. lack of proper incentives.

**Improving Communication Effectiveness:**

1. Clarify the ideas before communication.
2. Communicate according to the needs of receiver.
3. Consult others before communicating.
4. Be aware of language, tone and content of message.
5. Convey things of help and value to listeners
6. Ensure proper feedback.
7. Communicate for present as well as future.
8. Follow up communication: helps to remove hurdles, misunderstanding of instructions given by managers to subordination.
9. Be a good listener.

Class : 12th Business-studies  
Chapter - 7 : Directing





## Important Questions

### Multiple Choice Questions-

- Which of the following is an example of Non-financial incentives?
  - Recognition
  - Job Security
  - Status
  - All of the above
- The software company promoted by Narayana Murthy is
  - Infosys
  - HCL
  - Satyam
  - Wipro
- Esteem needs are concerned with \_\_\_\_\_
  - Affection
  - Prestige and Self-respect
  - Friendship
  - Acceptance
- Grapevine is
  - Formal communication
  - Informal communication
  - Lateral communication
  - Barrier to communication
- Directing is concerned with the following elements \_\_\_\_\_
  - Communication
  - Supervision and Motivation
  - Leadership
  - All of the above
- Two way communication technique is used under \_\_\_\_\_
  - Laissez Faire
  - Democratic style
  - Autocratic style
  - None of the above
- Hierarchy Theory of Motivation was given by \_\_\_\_\_
  - Abraham Maslow
  - Peter Maslow
  - Henry Maslow
  - David Maslow
- Which of the following is not a leadership style?
  - Free-rein
  - Autocratic
  - Democratic
  - Dictatorship
- Which of the following is a financial incentive?
  - Job Security
  - Promotion
  - Employee Participation
  - Stock Incentive
- Status comes under the following type of barriers
  - Psychological barrier
  - Semantic barrier
  - Non Semantic barrier
  - Organisational barrier
- Basic Physiological Needs are concerned with \_\_\_\_\_
  - Shelter
  - Hunger
  - Thirst
  - All of the above
- Supervision means \_\_\_\_\_
  - Planning for the future
  - Starting a business
  - Fulfilment of legal formalities
  - Overseeing what is being done by subordinates
- Bonus, Promotion and Recognition are the example of \_\_\_\_\_
  - Controlling
  - Positive Motivation
  - Staffing
  - Planning
- The process of converting the message into communication symbols is known as
  - Decoding
  - Encoding
  - Feedback
  - Media

15. Which of the following is not an element of the communication process?
- Communication
  - Channel
  - Receiver
  - Decoding

### Very Short-

- Mention the elements of directing?
- Explain how directing is a pervasive function of management.
- Mention one barrier to effective communication.
- Give any one measure to improve communication.
- It is concerned with instructing guiding and inspiring people in the organization to achieve its objectives. Name it.
- Every manager from top executive to superior performs the function of directing. Which characteristic of directing is referred here?
- It means overseeing the subordinates at work. Which element of directing is referred to?
- Supervisor acts as a link between workers and management. How?
- It refers to the way in which urges, drives, desires, aspirations, strivings or needs direct control and explain the behavior of human beings. Which element of directing is indicated here?
- Motivation can be either positive or negative. Give two examples of negative motivation.

### Short Questions-

- What is meant by Directing? Explain the importance of directing?
- 'Directing is the least important function of management.' Do you agree with this statement? Give any two reasons in support of your answer.
- "The post of supervisor should be abolished in the hierarchy of managers". Do you agree? Give any three reasons in support of your answer.
- What is meant by 'Esteem needs' and 'Self-actualization needs' in relation to motivation of the employees?
- It is through motivation that managers can inspire their subordinates to give their best to the organisation'. In the light of this statement, explain, in brief, the importance of motivation.

- "All managers are leaders, but all leaders are not managers." Do you agree with this statement? Give any three reasons in support of your answer.
- Explain the various leadership styles?
- Explain three advantages and three disadvantages of democratic leadership.
- Mention features of democratic leadership style?
- Mention the characteristics of laissez-faire leadership style.

### Long Questions-

- Explain the nature and importance of communication in today's changing business world.
- Explain the nature and importance of Motivation.
- Explain in brief the importance of supervision.
- Explain in brief the elements of the communication process.
- Explain in brief the functions of a supervisor.
- What is the importance of leadership? Explain.

### Case Study Based Question-

- Smita had been working as an assistant manager with 'Johnson Enterprises' for the last ten years. She was very popular amongst her colleagues because of her commitment and dedication towards the work. When the manager senior to her retired, all her colleagues thought that now Smita would be promoted. But to everyone's surprise, the vacant post was filled by an outsider, Mrs. Rita. Smita felt demoralised, and her performance started declining. She would abstain herself often and could not meet her targets.

Mrs. Rita was a good leader, who would not only instruct her subordinates but would also guide and inspire them. She noticed Smita's behaviour and felt that her performance could be improved. She started involving Smita in decision making-issues related to the organisation and made her a part of high-level joint management committee. Smita was now punctual in office identifying, and her performance started improving.

- Identify the function of management being performed by Rita.
- Name the element of the above function of management which helped Rita to improve Smita's behaviour.



- c. State any three features of the element identified in (2) above.
2. Umang Gupta is the Managing Director of Denver Ltd. The company had established a good name for itself and had been doing well. It was known for timely completion of orders. The Production Manager, Ms. Kanta was efficiently handling the processing of orders and had a team of fourteen motivated employees working under her. Everything was going on well. Unfortunately she met with an accident. Umang knew that in the absence of Ms. Kanta, the company may not be able to meet the deadlines. He also knew that not meeting the deadlines may lead to customer dissatisfaction with the risk of loss of business and goodwill. So, he had a meeting with his employees in which accurate and speedy processing of orders was planned. Everybody agreed to work as team because the behaviour of Umang Gupta was positive towards the employees of the organisation. Hence everyone put in extra time and efforts and the targets were met on time.

Not only this, Umang visited Ms. Kanta and advised her to take sufficient rest.

- Identify the leadership style of Umang Gupta and draw a diagram depicting the style.
- State any two values highlighted by the behaviour of Umang Gupta.

### Assertion Reason Question-

- In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.

- Assertion and reason both are correct statements and reason is correct explanation for assertion.
- Assertion and reason both are correct statements but reason is not correct explanation for assertion.
- Assertion is correct statement but reason is wrong statement.
- Assertion is wrong statement but reason is correct statement.

**Assertion (A):** Informal Communication arises from the social interaction of people.

**Reason (R):** The information system of communication is generally referred to as the Grapevine.

- In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.

- Assertion and reason both are correct statements and reason is correct explanation for assertion.
- Assertion and reason both are correct statements but reason is not correct explanation for assertion.
- Assertion is correct statement but reason is wrong statement.
- Assertion is wrong statement but reason is correct statement.

**Assertion (A):** Job Security often makes people complacent and they do not perform efficiently.

**Reason (R):** There is no risk of job in case of Job Security.

## Answer Key

- Answer:** (d) All of the above
- Answer:** (a) Infosys
- Answer:** (b) Prestige and Self-respect
- Answer:** (b) Informal communication
- Answer:** (d) All of the above
- Answer:** (b) Democratic style
- Answer:** (a) Abraham Maslow
- Answer:** (d) Dictatorship
- Answer:** (d) Stock Incentive
- Answer:** (d) Organisational barrier
- Answer:** (d) All of the above
- Answer:** (d) Overseeing what is being done by subordinates
- Answer:** (b) Positive Motivation
- Answer:** (b) Encoding
- Answer:** (a) Communication

### Very Short Answer-

1. **Ans:** 1) supervision 2) motivation 3) leadership 4) communication
2. **Ans.** Directing is a pervasive function as every manager from top executive to superior performs it.
3. **Ans.** Poor listening skills of people.
4. **Ans.** Communicate according to the needs of receiver.
5. **Ans.** Directing
6. **Ans.** Directing takes place every level of management.
7. **Ans.** Supervision.
8. **Ans.** Supervisor conveys management ideas to the workers on one hand and workers problems to the management on the other.
9. **Ans.** Motivation.
10. **Ans.** a) Stopping increments b) Treating

### Short Answers-

1. **Ans:** Directing is telling people what to do and seeing that they do it to the best of their ability. It includes making assignment, explaining procedures, seeing their mistakes are corrected, providing on the job instructions and issuing orders.

Importance of Directing: -

1. It initiates action. It integrates employees' efforts
  3. It is the means of motivation
  4. It facilitates implementing changes.
  5. It creates balance in the organization
2. **Ans:** No, I don't agree with this statement.

**Importance of direction:** Direction may be regarded as the heart of the management process. It is explained under the following parts:

- a. **Initiates action:** All organizational activities are initiated through direction.
- b. **Integrates employees' efforts:** At all levels of management the subordinates under the managers.

Managers integrate the work of subordinates.

- c. **Means of motivation :** Directing helps in motivating employees towards organizational goals.

3. **Ans.** No, I don't agree, because a supervisor performs the following functions to achieve organization goals.

#### Functions of the supervisor:

- a. **Planning the work:** The supervisor has to determine work schedule for every job.
- b. **Issuing orders:** Supervisor issues orders to the workers for achieving coordination in his work.
- c. **Providing guidance and leadership:** The supervisor leads the workers of his department.
- d. Explains the policies and programmes of the organization to his subordinates and provide guidance
- e. Make necessary arrangement for supply of materials and ensure they are efficiently utilized.
- f. Deviations from the target if any are to be rectified at the earliest.
- g. To help the personnel departments in recruitment and selection of workers.

4. **Ans.**

- i. **Esteem Needs:** these needs are needs for self esteem and need for other esteem For Example: Self-respect, self-confidence etc.
- ii. **Self-actualization Needs:** This is the needs to be what one is capable of becoming and includes needs for optimal development.

5. **Ans.** Importance of motivation:

- i. Motivation sets in motion the action of people: Motivation builds the will to work among employees and puts them into action.
- ii. Motivation includes the efficiency of work performance: Performance of employees dependence not only on individual abilities but also on his willingness.
- iii. Motivation ensures achievement of organizational goals: If employees are not motivated, no purpose can be served by planning organizing and staffing.
- iv. Motivation creates friendly relationships: Motivation creates friendly and supportive relationships between employer and employees.



- v. Motivation leads to stability in the employees: Motivation helps in reducing absenteeism and turnover.
- vi. Motivation helps to change negative/ indifferent attitudes of an employee

6. **Ans.** Yes, I agree with this statement.

Difference between leadership and management:

Basis	Leadership	Management
Origin	Leadership originates out of individual influence	Management originates out of official power and rights.
Formal Rights	A leader has no formal rights	A manager has certain formal rights
Follower & subordinates	A leader has followers	A manager has subordinates

7. **Ans: Autocratic leadership style:** This style is also known as leader centered style. The leader keeps all the authority and employees have to perform the work exactly as per his order. He does not decentralizes his authority. The responsibility of the success or the failure of the management remains with the manager.

**Democratic leadership:** This style is also known as group centered leadership style. Managerial decisions are not taken by the manager in consultation with employees. This leadership style is based on decentralization. Managers respect the suggestions made by his subordinates.

**Laissez-faire leadership style:** this style as leadership is also known as free brain leadership or individual centered style. The manger takes little interest in managerial functions and the subordinates are left on their own. Manager explain over all objectives; help sub-ordinates in determining their own objectives. They provide resources. They also advise the employees.

8. **Ans. Advantages:**1. Democratic leadership style advantages, 2. Morale, 3.Creation of more efficiency and productivity,4.Availability of sufficient time for constructive work

**Disadvantages:**1. Requirement of educated subordinates 2. Delay in decisions 3.Lack of responsibility and managers

9. **Ans.**

- 1) co-operative relations
- 2) Relief in employees
- 3) Open communication

10. **Ans.** Full faith in sub-ordinates

- 1) Independent decision making system
- 2) Decentralization of authority
- 3) Self directed

### Long Answers-

1. **Answer:**

#### Nature Of Communication:

The foregoing definitions reveal the following characteristics of communication –

1. **Pervasive Function:** Communication is required at all levels of management and in all departments of the organization. It is an indispensable part of the management process. It is an activity of each and every manager. Therefore, communication is regarded as a pervasive function.
2. **Continuous Process:** Communication is an ongoing process that has to be in regular touch with their subordinates and superiors to maintain and improves performance.
3. **Two-Way Process:** Communication is a two-way process. It includes sending a message and the response to that message. It is not complete until the reaction or response to the message is available. The reaction or response is known feedback.
4. **Circular Process:** Communication becomes a circular process with feedback. The flow of communication is a circular one.
5. **Two or more Parties:** It requires at least two persons to complete the process of the communication-a sender with the message and a receiver who must understand the message and respond to it.
6. **Understanding:** The receiver may or may not agree with the point of view of the sender of the message. However, for communication to be complete, the receiver must understand the message in the same sense as intended by the sender.



**Importance of Communication:**

Communication is an indispensable part of the process of management. Non an organization can survive and grow without an effective system of communication. Since the job of a manager is to get things done through others, he has to spend a major portion of his time on communication. The first executive function is to develop and maintain a system of communication. Most of the problems of management arise due to a lack of understanding. Therefore, communication's the number one problem of management today:

Sound communication offers the following benefits:

**1. Basis of Planning and Decision Making**

**Communication is essential for decision-making and planning:** The quality of managerial depends on the quality of communication (amount and quality of information available to the organization) Communication provides the necessary information with the help of which managers can diagnose problems, evaluate alternative courses of action and choose the right alternative.

Realistic Planning and sound decision making is not possible without accurate information through communication, for example, the entire sales plan of an enterprise may fail if the information about the latest market condition is not available to management. At the same time, the decisions and plans of management need to be communicated to the subordinates. Effective communication is also helpful for the proper implementation of plans and policies of the management.

**2. Smooth and Efficient Operation:** An effective communication system serves as a lubricant, fostering the smooth and efficient functioning of the enterprise. The achievement of goals of the enterprise is of paramount importance and communication is one of the important tools available to the manager to attain them. It is through communication that a manager issues orders and instructions and changes and regulates the behavior of subordinates in the desired direction. Effective communication promotes managerial efficiency and facilitates leadership.

**3. Facilitates Coordination:** In every organization, the work to be done is divided among several interrelated departments and sections. The activities and efforts of different individuals and groups must be coordinated. Communication is the most effective means of creating cooperation and coordination. The exchange of ideas and information helps in bringing about the unity of action in the pursuit of a common purpose.

Communication binds people together. Group meetings used in coordination involve the exchange of ideas and knowledge and the transfer of information and understanding. Communication is at the root of all group activity. It is through coordination that managers come closer to employees. Interaction and discussion between the two sides improve the superior-subordinate relationships.

**4. Employee Motivation and Moral:**

Communication helps management to keep the employees fully informed about the plans, job changes, etc. The motivation and morale of employees tend to be high when they clearly understand what they are supposed to do. Sharing of information with employees and discussion with them on matters of common interest provide satisfaction to employees.

Communication is the means by which employees can bring their suggestions, difficulties, and grievances to the notice of the management. Upward communication ensures greater job satisfaction and stimulates worker's enthusiasm and loyalty towards the enterprise. Effective communication satisfies the personal and social of employees.

**5. Sound Industrial Relations:** Effective communication helps to create mutual understanding and trust between the employer and the employees. It enables the management to come into close contact with workers. It serves as a bridge between management and labor and creates a spirit in the organization. Thus, an effective communication system is a prerequisite for good labor-management relations.



6. **Industrial Democracy:** Communication is essential for worker's participation in management. It is helpful in the delegation and decentralization of authority. Effective communication is the basic training and development of managerial personnel. The process of leadership itself depends upon effective communication.

**Public Relations:** In the modern business world, every business enterprise must create and maintain a good corporate image in society. Communication is an indispensable means of developing a favorable public opinion. It is through communication that management can keep cordial relations with the government, trade unions, customers, and the community.

In modern business the role of communications has increased due to the following reasons:

- (a) Increasing size of organizations.
- (b) Growing complexities in decision making.
- (c) Rapid changes in technology.
- (d) Need for better industrial relations.
- (e) Growth of trade union movements.
- (f) Need to improve public relations,
- (g) Increasing Competition.

## 2. Answer:

### Importance Of Motivation:

The success of an organization to a great extent depends upon the motivation of its employees. By motivating employees, managers can obtain their best performance towards the achievement of organizational and individual goals. Motivation is the core of management due to the following reasons.

1. **Higher Efficiency:** The level of performance of employees in an organization depends on their abilities and willingness to work hard. Motivation bridges the gap between the ability to work and willingness to work. It induces employees to contribute their maximum efforts to achieve a higher level of performance. Therefore, motivation helps in increasing production and reducing the cost of operations.

2. **Optimum utilization of Resources:** Every organization has physical, financial, and human resources. Effective utilization of physical and financial resources requires competent and motivated people. Motivation creates the willingness to work among employees. It enables managers to achieve the best possible utilization of all resources.

3. **Achievement of Organisational Goals:** The objectives of an organization cannot be realized unless the people working in it are motivated to work hard contribute their best towards the fulfillment of the assigned tasks. Management can secure the willing cooperation of subordinates towards the accomplishment of organizational goals by satisfying their needs through appropriate rewards. Motivated employees fully cooperate with management in achieving the desired results.

4. **Stability in the Workforce:** Motivation creates confidence in employees. It helps to improve their loyalty and commitment towards the organization. As a result, the rates of labor absenteeism and labor turnover are reduced. This leads to the maintenance of a stable workforce. The knowledge skills and experience of employees continue to be available to the organization.

5. **Cordial Relations:** Motivation brings satisfaction among employees through monetary and non-monetary rewards. Therefore, it leads to a friendly and supportive relationship between the employer and employees. Industrial disputes are reduced and the morale of employees is increased.

6. **Facilitates change:** Effective motivation helps management in overcoming resistance to change motivated employees and to support all changes that are in the interest of the organization. This is because they identify their own progress with the prosperity of the enterprise.

7. **Corporate linage:** When the employees of an organization are motivated and satisfied, the organization makes rapid progress and its reputation improves. Thus, motivation

helps in building a better image of the enterprise. As a result, the enterprise is able to attract qualified and competent people.

3. **Answer:**

**Supervision:** The term supervision can be understood in two ways. Firstly, it can be understood as an element of directing and secondly as a function performed by supervisors in the organizational hierarchy.

As an element of directing every manager in the organization supervises their subordinates. In this sense, supervision can be understood as the process of guiding the efforts of employees and other resources to accomplish the desired objectives. It means overseeing what is being done by subordinates and giving instructions to ensure optimum utilization of resources and achievement of work targets.

Secondly, supervision can be understood as functions to be performed by a supervisor, a managerial position in the organization hierarchy at the operative level i.e., immediately above the worker. The functions and performance of a supervisor are vital to any organization because he is directly related to workers whereas other managers have no direct touch with bottom-level workers.

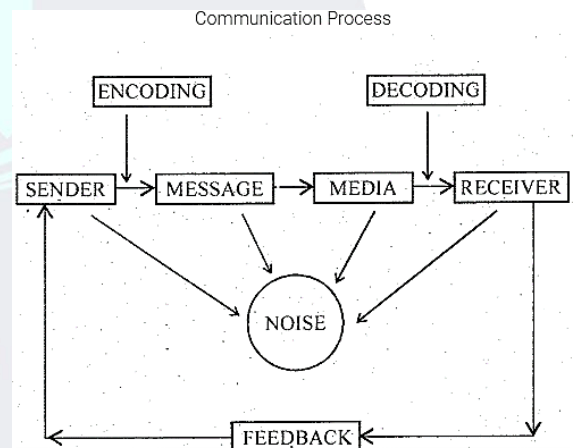
**Importance of Supervision:**

The importance of supervision can be understood from multiple roles performed by a supervisor. These are explained below.

1. Supervisor maintains day to day contact and maintains friendly relations with workers. A good supervisor acts as a guide, friend, and philosopher to the workers.
2. Supervisor acts as link-between workers and management. He conveys management ideas to the workers on one hand and workers' problems to the management on the other. This role played by the supervisor helps to avoid misunderstandings and conflict between management and workers/employees.
3. Supervisor plays a key role in maintaining group unity among workers placed under his control. He sorts out internal differences and maintains harmony among workers.

4. Supervisor ensures the performance of work according to the targets set. He takes responsibility for task achievement and motivates his workers effectively.
5. Supervisor provides good on-the-job training to the workers and employees. A skilled and knowledgeable supervisor can build an efficient team of workers.
6. Supervisory leadership plays a key role in influencing the workers in the organization. A supervisor with good leadership qualities can build up high morale among workers.
7. A good supervisor analyses the work performed and gives feedback to the workers. He suggests ways and means of developing work skills.

4. **Answer:** Elements Of Communication P: Communication has been defined as a process. This process involves the elements like source, encoding, media/channel, receiver, decoding, noise, and feedback. The process is represented in the figure below.



The elements involved in the communication process are explained below -

1. **Sender:** Sender means a person who conveys his thoughts or ideas to the 'receiver'. The sender represents a source of communication.
2. **Message:** It is the content of ideas, feelings, suggestions, order, etc. intended to be communicated.
3. **Encoding:** It is the process of converting the message into communication symbols such as words, pictures, gestures, etc.
4. **Media:** It is the path through which an encoded message is transmitted to the receiver. The channel may be in written form, face to face, phone call, internet, etc.



5. **Decoding:** It is the process of converting encoded symbols of the sender.
6. **Receiver:** The person who receives communication from the sender.
7. **Feedback:** It includes all those actions of the receiver indicating that he has received and understood the message of the sender.
8. **Noise:** Noise means some obstruction or hindrance to communication.

The hindrance may be caused to sender, message, or receiver. Some examples of noise are:

- (a) Ambiguous symbols that lead to faulty encoding.
- (b) A poor telephone connection.
- (c) An inattentive receiver.
- (d) Faulty decoding (attaching wrong meanings to message)
- (e) Prejudices obstructing the poor understanding of the message.
- (f) Gestures and postures that may distort the message.

5. **Answer:** Functions of a supervisor:

The function performed by a supervisor are briefly discussed below –

1. **Preparation of Work Schedules:** Scheduling involves laying down the time for starting and completing various activities. The supervisor determines the schedules of work for every individual in his unit or section. This is done to ensure a steady flow of work.
2. **Improving Communication:** The supervisor maintains direct contact with the subordinates which leads to effective communication. He also provides leadership to the workers of his department. He fixes production targets for them and provides them the necessary guidance for doing the work assigned to them.
3. **Optimum Utilisation of Resources:** The supervisor issues orders and instructions to the workers for achieving coordination in section. He tells them what to do and how to do it so that they may utilize machines, materials, money, and methods effectively.
4. **Providing Motivation:** The supervisor

motivates his subordinates by providing financial and non-financial incentives. He inspires them for higher quality and productivity.

5. **Control of Performance:** The supervisor controls the performance of the workers by comparing their performance with the standards. He takes necessary action to ensure that goods are produced according to the predetermined standards. He also provides feedback to the subordinates about their performance and gives them counseling for improvement.
6. **Reporting:** The supervisor keeps records of output and other related aspects of each employee. On the basis of records, he sends performance reports and other necessary information to his superior.
7. **Link Between Management and Workers:** The supervisor is an important link between the management and the workers. He explains management policies to the workers and also passes on the management's instructions. He has close contact with the workers and tries to understand their problems. He brings worker's problems to the notice of the top management.
8. **Human Relations:** A supervisor tends to achieve good human relations in his unit. He can mix up with the workers and share their joys and sorrows. He also settles conflicts between workers or groups of workers.
9. **Grievance Handling:** A supervisor is in direct touch with the workers, so he can handle their grievances effectively. When a grievance is reported, he listens to the worker's viewpoint and tries to remove the cause of grievance. But if he can't redress the grievance he should report it to the upper-level management.
6. **Answer:** Importance of Leadership:  
Leadership is considered the most important element of the directing function of management. It supports all other managerial functions by assisting in the formulation and execution of plans. Good leadership provides the following benefits.

1. **Clarification of Goals:** A leader interprets and explains the objectives of the group to his followers. As a result, the members of the group know the targets to be achieved and the contribution, each of them is to make towards common objectives. They are not likely to go astray and will continue in the right direction.
2. **Motivation:** A good leader creates- an urge for higher performance among people. He creates self-confidence and enthusiasm among his subordinates. He converts lukewarm desire into a burning passion for success. A sound leader can create an environment conducive to hard work. He directs the potential talent of employees towards the achievement of goals.
3. **Moral Building:** A leader builds up dedication and loyalty among a group of people. He develops mutual cooperation and self-discipline among people. The persons become ready to sacrifice even their lives for the good of the common goal. Under a good leader, people work willingly and enthusiastically. The leader encourages subordinates to take initiative and provides psychological support to them. He serves as a friend, philosopher, and guide for his group.
4. **Teamwork:** An organization can be successful only when all its members work together as a team rather than going in different directions. It is the leader who creates team spirit and coordination among different members of the group. He resolves internal conflicts and differences, of opinion. He serves as an arbitrator and mediator among the members. A leader harmonizes the personal goals and aspirations of subordinates with the goals of the organization as a whole.
5. **Creates dynamic environment:** In the dynamic environment of today, frequent changes are required in the structure and working of an organization. But change creates uncertainly and inconvenience. Therefore, people tend to resist change. A good leader persuades people to accept and carry out the desired changes. A leader is an

important agent of organizational change and development. He provides psychological support to his followers.

6. **Representation:** A leader serves as the representative of his followers. He protects their interest and serves as their guardian. He acts as their spokesman and bargains with the outside forces for the welfare of the groups. A true leader upholds the interests of his followers and attempts to fulfill their hopes and aspirations. He is always ready to solve the problems of his followers. A leader manager represents his organization in business meetings, trade conferences, government committees, and so on.

Competent leadership is required at all levels of management. All managers must provide leadership so as to create an urge in the employees to cooperate and improve their performance towards the achievement of organizational objectives.

### Case Study Answer-

#### 1. Answer:

- a. **Directing** is a complex managerial function consisting of all the activities that are designed to encourage subordinates to work effectively. It includes supervision, motivation, communication and leading.
- b. **Motivation:** Motivation is the process of stimulating people to action to accomplish desired goals of organisation. It is an internal feeling of an individual and leads to goal directed behaviour. Motivation is mainly based on needs of individuals. It helps individuals and groups in the organisation for improved performance.

#### c. Features of motivation:

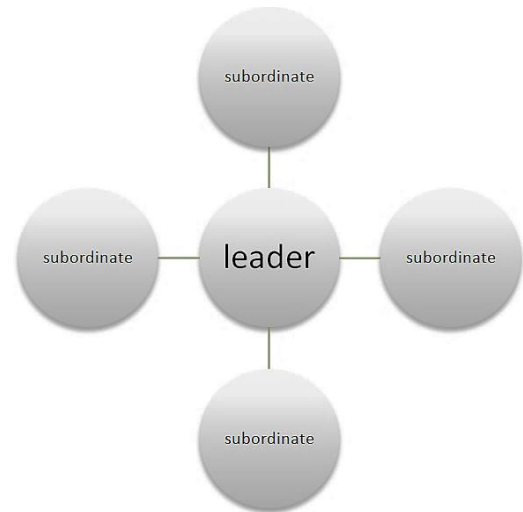
- Motivation is an internal feeling. The urge, drives, desires, aspirations, striving or needs of human being, which are internal, influence human behaviour
- Motivation can be either positive or negative. Positive motivation provides positive rewards like increase in pay, promotion, recognition etc. Negative motivation uses negative means like punishment, stopping increments, threatening etc. which also may induce a person to act in the desired way.



- Motivation is a complex process as the individuals are heterogeneous in their expectations, perceptions and reactions. Any type of motivation may not have uniform effect on all the members.

2. **Answer:**

- a. **Democratic or Participative leader:** A democratic leader will develop action plans and makes decisions in consultation with his subordinates. He will encourage them to participate in decision making. This kind of leadership style is more common nowadays, since leaders also recognize that people perform best if they have set their own objectives. They also need to respect the other's opinion and support subordinates to perform their duties and accomplish organizational objectives. They exercise more control by using forces within the group.



- b. Two values highlighted by the behavior of Umang Gupta are:  
 Positive attitude of Umang towards the employees was really very appreciable.  
 Team spirit: Umang believed that working together as a team will surely pave way for success.

**Assertion Reason Answer-**

1. b. Assertion and reason both are correct statements but reason is not correct explanation for assertion.
2. a. Assertion and reason both are correct statements and reason is correct explanation for assertion.



# Controlling | 8

## Meaning & Definition:

Controlling involves comparison of actual performance with the planned performance. If there is any difference or deviation, then finding the reasons for such difference and taking corrective measures or action to stop those reasons so that they don't re-occur in future and that organizational objectives are fulfilled efficiently.

"Managerial Control implies the measurement of accomplishment against the standard and the correction of deviations to assure attainment of objectives according to plans."  
*-Kontz and O'Donnell.*

## Importance Of Controlling:

1. **Controlling helps in achieving organizational goals:** The controlling function tracks progress toward organizational objectives and flags any deviations so that remedial action can be taken.
2. **Judging accuracy of standards:** An effective control system allows management to determine if the standards set are accurate or not by closely monitoring changes in the organization's environment.
3. **Making efficient use of resources:** A manager can reduce resource waste by effectively utilizing resources through the controlling process.
4. **Improving employees' motivation:** An effective control system guarantees that staff are aware of what they are expected to do as well as the performance requirements. As a result, it inspires and assists them in delivering superior results.
5. **Ensuring order and discipline:** By maintaining a careful eye on the activities of its employees, the controlling function generates an atmosphere of order and discipline in the firm.
6. **Facilitating Coordination in action:** The last and most crucial role of controlling is to ensure that each department and employee is governed by predetermined standards and goals that are well-understood and coordinated. This guarantees that the organization's overall goals are met in a timely way.

## Limitations Of Controlling:

1. **Difficulty in setting quantitative standards:** Control system loses some of its effectiveness when standards cannot be quantified.
2. **Little control on external factors:** An organisation cannot control external factors such as government policies, technological changes, competition etc.
3. **Resistance from employees:** Mostly employees resist controlling by managers.
4. **Costly affair:** Control is a costly process as it involves a lot of expenditure, time, and effort.

## Nature of Controlling/ Features of Controlling:

1. **Goal oriented:** Controlling is directed towards accomplishment of organizational goals in the best possible manner.
2. **Pervasive:** Controlling is an essential function of every manager and exercised at all levels of management.
3. **Continuous:** It is not an activity to be pursued in the end only; it has to be done on a continuous basis.
4. **Controlling is looking back:** Controlling involves measurement of actual performance and its comparison with the desired performance. It is the process of checking and verification.



5. **Controlling is forward looking:** It is related to future because it seeks to improve future results on the basis of experience gained in the past.
6. **Depends on planning:** It presupposes existence of planning because without planning no control is possible.
7. **Action oriented:** Control has no meaning if no corrective action is taken; So timely action should be taken to prevent deviations.

### Relationship between Planning and Controlling:

Planning and controlling are inseparable twins of management. Once a plan becomes operational, controlling is necessary to monitor the progress and deviations. Thus, planning without controlling is meaningless. Other hand controlling is blind without planning, if the predetermined standards are not set in advance, there is nothing to control.

Planning is looking Ahead whereas Controlling is Looking Back.

Plans are prepared for future and are based on forecasts about future conditions on the contrary controlling is like a post-mortem of past activities to find out deviations from the standards.

### Controlling Process:

1. **Setting Performance Standards:** Standards are the criteria against which actual performance would be measured. Thus, standards become basis for comparison and the manager insists on following of standards.
2. **Measurement of Actual Performance:** Performance should be measured in an objective and reliable manner which includes personal observation, sample checking. Performance should be measured in same terms in which standards have been established, this will facilitate comparison.
3. **Comparing Actual Performance with Standard:** This step involves comparison of actual performance with the standard. Such comparison will reveal the deviation between actual and desired performance. If the performance matches the standards, it may be assumed that everything is under control.
4. **Analysing Deviations:** The deviations from the standards are assessed and analysed to identify the causes of deviations.
5. **Taking Corrective Action:** The final step in the controlling process is taking corrective action. No corrective action is required when the deviation are within the acceptable limits. But where significant deviations occur corrective action is taken.

### Techniques of Managerial Control:

Managerial control classified into two categories:

- Traditional Techniques.
- Modern Techniques.

### Traditional Techniques:

1. Traditional techniques have been in use by managers since long ago. The following are traditional techniques of managerial control:
2. **Personal Observation:** It enables the manager to collect first-hand information, but it is very time consuming and cannot be used in all kinds of job.
3. **Statistical Reports:** Statistical analysis in the form of averages, percentages, ratios, correlation, etc., present useful information to the managers regarding performance of the organisation.
4. **Breakeven analysis:** is a technique to study the relationship between costs, volume, and profits.
5. **Budgetary Control:** is a technique of managerial control in which all activities are planned in the form of budgets and actual results are compared with budgetary standards.



## Modern Techniques:

1. **Return on Investment:** Return on Investment (ROI) is a technique which provides the basic yardstick for measuring whether invested capital has been used effectively for generating reasonable amount of return.

$$ROI = \frac{\text{Net income}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Total investments}}$$

2. **Ratio Analysis:** Ratio Analysis refers to analysis of financial statements by computation of various ratios.
  - Liquidity Ratios
  - Solvency Ratios
  - Profitability Ratios
  - Turnover Ratios
3. **Zero Based Budgeting:** It refers to a controlling technique where the budget is formed from scratch, and not referring to the previous budgets. Hence, in this budget is prepared as per the current conditions.
4. **Management Audit:** The term "management audit" refers to a systematic assessment of an organization's management performance.
5. **Management Information System:** A management information system (MIS) is a computer-based information system that provides data and support to help managers make better decisions. It's a crucial control strategy.

## Managers benefit from MIS in the following ways:

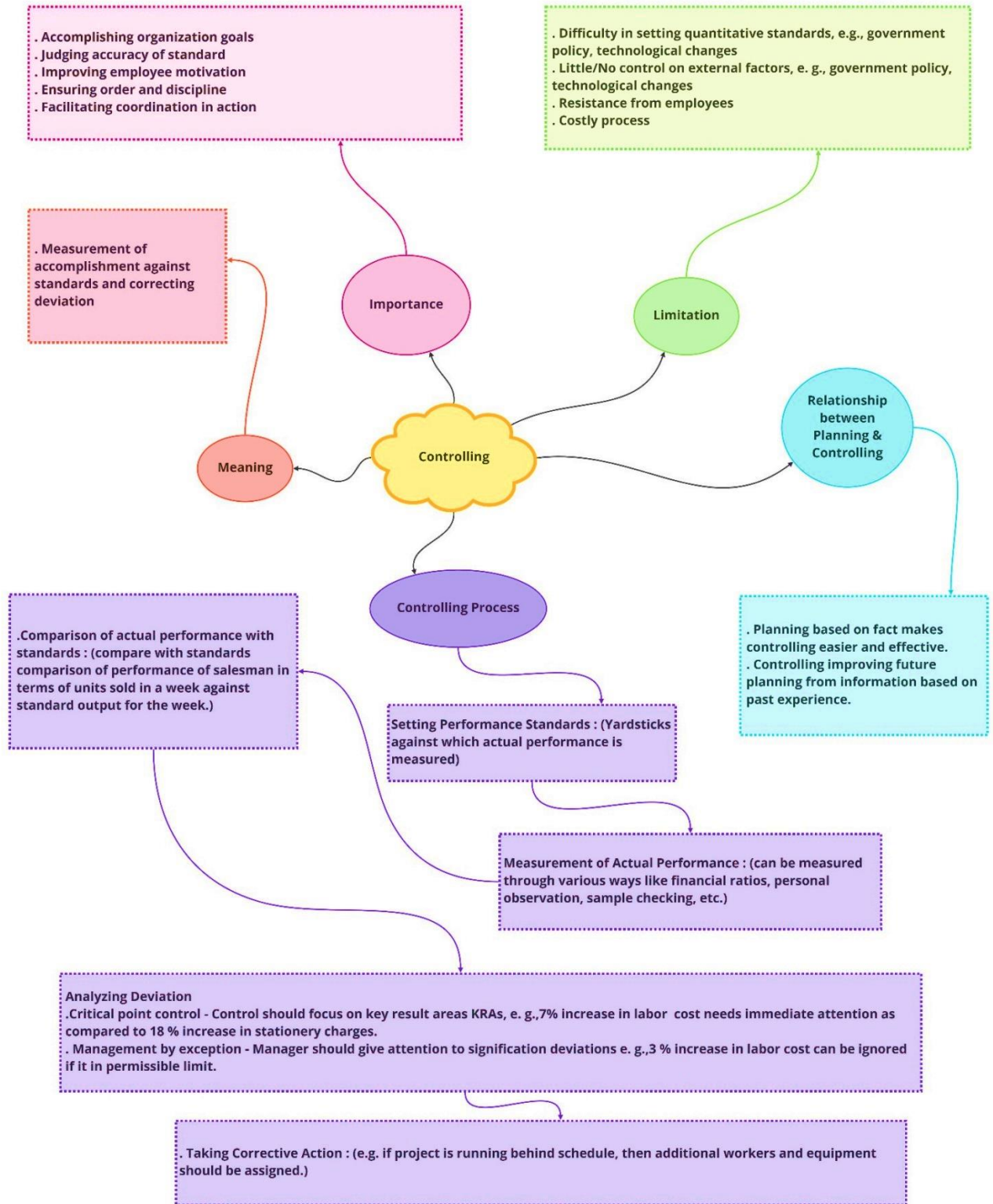
- It makes information collection, management, and dissemination easier.
- It facilitates all levels of planning and control.
- It enhances the information quality.
- It ensures value for money.
- It helps to alleviate information overload.



STEP UP  
ACADEMY



Class : 12th Business Studies  
Chapter-8 : Controlling



## Important Questions

### Multiple Choice Questions-

- Which of the following is not applicable to responsibility accounting
  - Accounting centre
  - Cost centre
  - Profit centre
  - Investment centre
- Management control is done by the \_\_\_\_\_
  - Managers at Top Level
  - Managers at Middle Level
  - Managers at Lower Level
  - All of the above
- What will be the corrective action for defective machinery?
  - Sell at the book value
  - Sell at a loss
  - Sell at a profit
  - Repair or Replace the machine
- Which of the following is not a technique of controlling?
  - Break-even analysis
  - Budget
  - Managerial Audit
  - Cash Flow Statement
- Technological up-gradation is the best corrective action in case of \_\_\_\_\_
  - Defective machinery
  - Defective material
  - Obsolete Machinery
  - None of the above
- What will be the corrective action for defective material?
  - Change in Quantity
  - Change in Price
  - Change in Quality Specifications for the material used
  - None of the above
- An efficient control system helps to
  - Judges accuracy of standards
  - Accomplishes organisational objectives
  - Boosts employee morale
  - All of the above
- Controlling is \_\_\_\_\_ aspect of management.
  - Physical
  - Practical
  - Mental
  - Theoretical
- What is the last step in the controlling process?
  - Setting Performance Standards
  - Taking corrective action
  - Comparing actual performance with standards
  - Measurement of actual performance
- Why actual performance is compared with standards?
  - To take corrective action
  - To improve the quality of material
  - To change the machinery
  - None of the above
- Controlling is \_\_\_\_\_
  - Economical
  - Costly
  - Free
  - Very Cheap
- Which of the following is a limitation of controlling?
  - Controlling improves employee motivation
  - Controlling is goal-oriented
  - Controlling is expensive
  - Controlling ensures order and discipline
- The main focus of controlling is on \_\_\_\_\_
  - Competition
  - External Forces
  - Results
  - Business Environment
- Management audit is a technique to keep a check on the performance of
  - Company
  - Management of the company
  - Shareholders
  - Customers



15. When actual performance is better than the standard performance it is called \_\_\_\_

- Negative Deviation
- Poor Deviation
- Positive Deviation
- None of the above

### Very Short-

- If you want to control everything you may end up controlling.
- Define Management Audit.
- Why is controlling considered to be a backward looking?
- Name two types of profitability ratios?
- What do you call the sales volume at which there is no profit, No loss?
- Give 2 examples of Corrective Action.
- Give two examples of responsibility centers.
- Marketing department comes under which type of responsibility center.
- Give the formula of Return on Investment.
- What do you understand by key KRAs result areas?

### Short Question-

- Mention the important features of the control function of management.
- Explain the term Management by Exception.
- Explain in brief the term Responsibility Accounting.
- Explain in brief the term Zero base budgeting.
- Explain the Modern technique of control by the management information system (MIS) a computer-based technique.
- Distinguish between Planning and Control.
- What are the advantages of Management audit?

### Long Questions-

- Explain the essential features of a sound control system.
- Explain the relationship of the controlling the function of management with other functions of management.

### Case Study based Question-

- Mr. Nath, a recently appointed production manager of Suntech Ltd., has decided to produce jute bags instead of plastic bags as these are banned by the government. He set a target of producing 1000 jute bags a day. It was reported that the employees were not able to achieve the target. After analysis, he found that employees were demotivated and not putting in their best for achieving the target. Mr. Nath's behaviour is good towards the employees. His attitude is always positive. So, he announced various incentive schemes for the employees like:
  - Installing awards or certificates for best performance
  - Rewarding an employee for giving valuable suggestions
  - Congratulating the employees for good performance
    - Identify the functions of management highlighted in the above paragraph.
    - State the incentive under which the employee are motivated.
    - State any two values which the production manager wants to communicate to society by his work and behaviour. (CBSE, Sample Paper 2015)
- A company was manufacturing LED bulbs which were in great demand. It was found that the target of producing 300 bulbs a day was not met by the employees. On analysis, it was found that the workers were not at fault. Due to electricity failure and shortage of workers, the company was not able to achieve the set targets and alternative arrangements were needed.
 

To meet the increased demand, the company assessed that approximately 88 additional workers were required out of which 8 would work as heads of different departments and 10 would work as subordinates under each head. The required qualifications and job specifications were also enlisted. It was also decided that necessary relaxations should be given to encourage women, people from backward and rural areas and people with special abilities to assume responsible positions in the organisations. All efforts were made to match the ability of the applicants with the nature of work.

- a. Identify the functions of management discussed above.
- b. State the two steps in the process of each function discussed in the above paragraph.
- c. List any two values which the company wants to communicate to the society. (CBSE, Delhi 2015)

### Assertion Reason Question-

1. In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.
  - a. Assertion and reason both are correct statements and reason is correct explanation for assertion.
  - b. Assertion and reason both are correct statements but reason is not correct explanation for assertion.
  - c. Assertion is correct statement but reason is wrong statement.
  - d. Assertion is wrong statement but reason is correct statement.

**Assertion (A):** Controlling can prevent deviations

**Reason (R):** Controlling helps to minimize deviations by taking actions and decisions that reduce their recurrence.

2. In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.
  - a. Assertion and reason both are correct statements and reason is correct explanation for assertion.
  - b. Assertion and reason both are correct statements but reason is not correct explanation for assertion.
  - c. Assertion is correct statement but reason is wrong statement.
  - d. Assertion is wrong statement but reason is correct statement.

**Assertion (A):** Control is exercised at all levels of management.

**Reason (R):** Controlling is a pervasive Function.

## Answer Key

### MCQ Answers-

1. **Answer:** (a) Accounting centre
2. **Answer:** (d) All of the above
3. **Answer:** (d) Repair or Replace the machine
4. **Answer:** (d) Cash Flow Statement
5. **Answer:** (c) Obsolete Machinery
6. **Answer:** (c) Change in Quality Specifications for the material used
7. **Answer:** (d) All of the above
8. **Answer:** (b) Practical
9. **Answer:** (b) Taking corrective action
10. **Answer:** (a) To take corrective action
11. **Answer:** (b) Costly
12. **Answer:** (c) Controlling is expensive
13. **Answer:** (c) Results
14. **Answer:** (b) Management of the company
15. **Answer:** (c) Positive Deviation

### Very Short Answer-

1. **Ans:** Management By Exception.
2. **Ans:** Systematic appraisal of the overall performance of the management of an organization.
3. **Ans:** Controlling involves evaluation of past activities to find out deviations from standards so it is a backward looking function.
4. **Ans:** a) Gross Profit Ratio  
b) Net Profit Ratio.
5. **Ans:** Breakeven Point (BEP).
6. **Ans:** a) Provide training  
b) Revive standards.
7. **Ans:** Cost Centre, revenue center etc.
8. **Ans:** Revenue Centre.
9. **Ans:** Net Profit  
Total investment
10. **Ans:** The areas which are critical to the success of an organization.



## Short Answers-

1. Characteristics of Control: The Control function of management has the following features:

1. **Controlling is a continuous Process:** It involves continuous measurement and review of actual performance and results in corrective action based on this review. It may lead to changes in planning, staffing, organizing, etc.
2. **Controlling is looking Back:** Control leads to the appraisal of past activities. Thus, it is looking back. The shortcomings in the performance of various individuals and departments are revealed by the control process. This is known as feedback information. It will help in knowing the reasons for poor performance. Corrective action can be initiated on the basis of feedback information.
3. **Control is forward-looking:** Control is said to be forward-looking. It is related to the future as the past cannot be controlled. It is usually preventive as the preserve of the control system leads to minimizing wastages, losses, and deviations from standards. It should be noted that control does not curtail the rights of individuals. It simply keeps a check on the Performance of individuals.
4. **Control is Action-Oriented:** Control implies taking corrective measures, whenever required. Action is the essence of control. The purpose of control is achieved only when corrective action is taken on the basis of feedback information. If the control does not lead to any action, then a manager can't ensure actual performance as per standards. A good system of control facilities timely action so that there is minimum wastage of resources, time, and energy.
5. **Control is a Pervasive function:** It is a basic function of every manger irrespective of his level of authority. It is a follow-up action to the other function of management. Every manager is responsible for controlling the activities of those working under him and taking necessary action whenever necessary.

2. **Management by exception:** Effective control can be achieved if critical or key points are identified and close attention is directed to adjustment at these points. This is known as 'control by exception'. According to this principle, only significant deviations from the standards require management's attention as they constitute exceptions. An attempt to go through all deviations tends to increase the workload of the Manager and decrease attention on important problems.

For instance, if postal expenses mqt&ase by twenty percent, the deviation is too insignificant to require managerial attention. On the other hand, if labor costs rise by twenty percent, they should receive immediate managerial attention.

The Principle of Management by exception implies that minor deviations from the standards may be ignored or given less attention. This would conserve managerial time, effort, and energy which could be utilized on important matters. But whenever deviations from standards are higher than the accepted level, management must take corrective measures to deal with the situation.

3. **Responsibility Accounting** is a system of control where responsibility is assigned for the control of costs. The persons are made responsible for the control of costs. Proper authority is given to the persons so that they are able to keep up their performance. In case the performance is not according to the predetermined standards then the persons who are assigned this duty will be personally responsible for it.

In responsibility accounting, the emphasis is on men rather than on systems e.g. if Mr. A, the manager of a department, prepares the cost budget of his department then he will be made responsible for keeping the budget under control. A will be supplied with full information of cost incurred by this department. In case the cost incurred is more than the budgeted costs, then A will try to find out reasons and take necessary corrective measures. A will be personally responsible for the performance of his department.

4. **Zero Based Budgeting** Whenever a budget is prepared, past records and experience are taken into consideration. The new budget is prepared

on the basis of budgets of the previous period. This method is known as 'Based Budgeting'. On the contrary, the concept of zero-base budgeting considers the future not a mere projection of the past. As the environment is changing fast, the need to forecast systematically future events arise. For the growth and survival of any business organization, these changes need to be adopted.

Zero-base budgeting is the latest technique and it is meant for a particular period of time. It doesn't prepare an altogether new budget. Normally, the previous year's performance is taken as a base for the current year's budget in budgeting techniques. But in zero-base budgeting, every year is taken as a new year, and the previous year is not taken as a base.

Zero is taken as a base and all budget proposals are considered in the light of present conditions. In zero-based budgeting, the amount to be spent on various activities will depend upon justification given by the manager.

Hence, zero-based budgeting provides flexibility and freedom in allocating the resources and the chances of repletion of weaknesses of the previous year are reduced.

5. Management information system: A management information system (MIS) is a computer-based information system that provides information and support for effective managerial decision-making. A decision-maker requires up to date, accurate and timely information. MIS provides the required information to the managers by systematically Processing massive data generated in an organization. Thus, MIS is an important communication tool for managers.

MIS also serves as an important control technique. It provides data and information to the managers at the right time so that appropriate corrective action may be taken in case of deviations from standards.

MIS offers the following advantages to Managers:

1. It facilitates the collection, management, and dissemination of information at different levels of Management and across different departments of the Organisation.
2. It supports planning, decision making, and controlling at all levels.
3. It improves the quality of information with

which a manager works.

4. It ensures cost-effectiveness in managing information.
  5. It reduces information overload on the managers as only relevant information is provided to them.
6. A comparison of Planning and Control:

Planning	Control
1. Planning emphasizes more on non-personal, abstract long-range problems.	1. Control emphasizes more and long-range problems.
2. Planning is based on estimates	2. Control is based on estimates.
3. Planning is done by top-level executives.	3. Control is done by top-level executives.
4. Under Planning, the evaluation of results is very difficult.	4. Under Control, the evaluation of results is very difficult.
5. Determination of results takes a very long time.	5. Determination of results takes a very long time.

7. The main advantages of Management audit are as follows.

1. It helps to locate present and potential deficiencies in the performance of management functions.
2. It helps to Improve the Control system to an Organisation by continuously monitoring the performance of Management.
3. It Improves Coordination in the functioning of various departments so that they work together effectively towards the achievement of organizational objectives.
4. It ensures updating of existing managerial policies and strategies in the light of environmental changes.

Conducting a management audit may sometimes pose a problem as there are no standard techniques of management audit. Also, management audit is not compulsory under any law. Enlightened managers, however,



understand its usefulness in improving the overall performance of the organization.

### Long Answers-

#### 1. Essential features of a sound control system:

A good control system has the following essential features:

1. **Clear out objectives:** Before Planning a control system, it is essential to know clearly the objectives it will tend to achieve. The standards of performance should be based on these objectives. Thus, the control system should be directed towards the detection of early deviations from the standards to permit effective corrective action. If the standards are arbitrary or subjective in nature, they will not be able to measure deviations properly. Thus, the purpose of control will be lost.
2. **Suitability:** Control techniques should be appropriately designed to suit the nature of the activities being controlled. This means that different types of activities need different types of control techniques. The control technique should be tailored to reflect the performance of all types of operations, say, production or sales.  
It is also essential that the overall control system should be appropriate for the organization. A control system that is good for a small organization may be inadequate for a big organization.
3. **Simplicity:** A good system of control should be simple and easy to understand. The employees must know what is expected of them and how their performance will be evaluated. If the employees don't understand the standards of performance properly, the actual performance might turn out to be very poor.
4. **Economy:** The system of control must be worth its costs. It must justify the expenses involved. A control system is justifiable if the savings anticipated from it exceed the costs of its working. Small enterprises cannot afford elaborate control systems which are very costly. As far as possible, unnecessary paperwork and reports should be avoided.
5. **Flexibility:** A good control system must

keep pace with the continuously changing environment. It must be responsive to changing conditions. It should be adaptable to new developments such as the introduction of new methods, materials, and changes in the requirements of the customers. If there is a change in any plan, the control system should be capable of absorbing such change.

6. **Forward-looking:** The system of control should be forward-looking in the sense that it should detect and report deviations promptly. Timeless is the essence of control. Ideally, deviations should be anticipated and preventive action should be taken. More realistically information on deviations should be monitored and feedback to the system immediately so that corrections are effected with minimum cost and inconvenience.
7. **Suggesting Corrective Action:** Merely pointing out deviations is not sufficient in a good control system. It must lead to taking corrective action to achieve the desired objectives. It may result in taking suitable action against the employees, giving them training, ensuring effective supervision, improving communication, revising standards, etc.
8. **Concentration on exceptions:** This is also known as 'Control significant deviations from standards require management's attention as they constitute exceptions. An attempt to go through all deviation tends to increase unnecessary efforts and to decrease attention on important problems.
9. **Strategic Point Control:** Small deviations in certain cases may have greater significance than larger ones in other cases, for example, deviation of ten percent in budgeted labor cost may be more troublesome to a manager than a deviation of twenty-five percent in budgeted postal charges. The Principle of strategic point control states that effective control can be achieved if critical, key, or strategic points can be identified and close attention directed to adjustment at those points. In fact, strategic point control is an extension of control by exception.



2. Relationship of control with other Function of Management: We know that control is the last function of management because its need arises only after performing the functioning of planning, organizing, and directing. But being the last function does not lower down its importance as compared to other functions. Control is very much linked to other functions of management. In fact, the success of all other functions depends upon effective control,

The relation of Control with other managerial functions is explained below:

1. **Relationship of Control with Planning:**

There is a close relationship between the Control and Planning functions of Management. Planning is the basis of Control, The control process involves determining the standards, comparison of the deviations, and taking corrective action to remove such deviations. In this process, planning provides such standards against which the progress of the actual performance is compared.

Thus where there is no plan there can be no basis for control. HG Hick has rightly said that "Planning is clearly a prerequisite for controlling. It is utterly foolish to think that controlling could be accomplished without planning there is no predetermined understanding of the desired performance.

On the other hand, plans will also prove mere imaginations in the absence of control. Because in such a case there will be no one to check whether or not everything is being done according to plans. Also in the absence of control, there will be no corrective action to direct the actual progress towards the accomplishment of plans.

Thus planning is meaningless without control, and control is aimless without planning.

2. **Relationship of control with the organization:** Control can be meaningful only when the person responsible for deviations is identified and is held responsible. This is possible only because of the organization because it is only in an organization that the authority and responsibility of each one are defined. In the

absence of organization, neither the person responsible for committing the mistakes will be identified nor any action can be taken against him. Hence, the same mistakes will be repeated time and again. As such, effective organization is essential for effective control.

Similarly, Organisation is also dependent upon control because organizing is to assign work to individuals and give them authority and fix responsibility in case of mistakes. Since fixing of responsibility' is possible only through Control, therefore effective control is essential for effective organization.

3. **Relationship of control with Direction:**

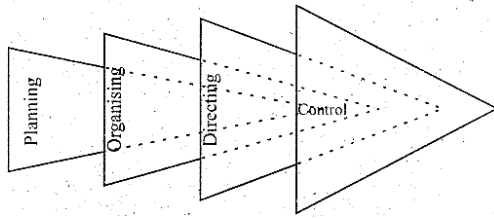
Direction removes the difficulties in the way of various functions even before they are reviewed in order to control their progress. Direction makes the employee more capable and enthusiastic towards their work and provides them with adequate guidance training and supervision. Thus direction and control are interlinked with each other.

4. **Relationship of control with other functions of Management:**

Control has deep relations with other functions of management as well. Communication helps in comparison of actual results with the standards by providing timely information of actual results with the standards by providing timely information of actual progress. Decision-making helps in determining the way to remove the deviations and the type of corrective actions to be undertaken.

Motivation helps in encouraging people to work towards the achievement of organizational objectives. Under control performance of each person is evaluated and efficient persons are motivated by providing them financial and non-financial incentives whereas inefficient employees are provided training to remove their deficiencies. Thus, it is clear that all the functions of management are inter-linked.

The relationship of various managerial functions is depicted through the following diagram:



From the above diagram, it is clear that the relationship between control and other managerial function is so deep that it is impossible to think of them separately. Every function affects the control and gets affected by it.

### Case Study Answer-

#### 1. Answer:

- a. The functions of management highlighted in the above paragraph are Controlling and Directing.
- b. The employees are motivated under Employee recognition programmes which is a non-financial incentive. Employee recognition programmes helps to fulfill the need of due consideration and appreciation of the people working in an organisation. It boosts their self-esteem and motivates them to work with greater zeal and enthusiasm.
- c. The two values that the manager wants to communicate to the society through his work and behaviour are:
  - Respect for employees
  - Concern for environment

#### 2. Answer:

- a. The functions of management discussed above are Staffing and Controlling.
- b. The two steps involved in staffing function are as follows:
  - **Estimating manpower requirements:** The manpower requirements of an organisation are estimated through workload analysis and workforce analysis. The workload analysis helps to determine the number and type of human resource required in the organisation to meet its

present and future needs. Whereas workforce analysis seeks to determine the number and type of human resource available within the organisation.

- **Recruitment:** The process of recruitment involves searching for the prospective candidates and stimulating them to apply for jobs in the organisation. There are two sources of recruitment namely, internal and external.

The two steps involved in controlling function are as follows:

- Comparing actual performance with standards to identify deviations if any.

“It was found that the target of producing 300 bulbs a day was not met by the employees.”

- Analysing deviations through critical point control and management by exception approach to identify the causes for their occurrence. “On analysis, it was found that the workers were not at fault. Due to electricity failure and shortage of workers, the company was not able to achieve the set targets and alternative arrangements were needed.”
- Taking corrective action, if required “To meet the increased demand, the company assessed that approximately ... as subordinate under each head.”

- c. The two values that the company wants to communicate to the society are:
  - Women empowerment
  - Kindness.

### Assertion Reason Answer-

1. d. Assertion is wrong statement but reason is correct statement.
2. a. Assertion and reason both are correct statements and reason is correct explanation for assertion.



# Financial Management | 9

## Introduction to Financial Management:

Let's define financial management as the first part of the introduction to financial management. For any business, it is important that the finance it procures is invested in a manner that the returns from the investment are higher than the cost of finance. In a nutshell, financial management.

- Endeavors to reduce the cost of finance
- Ensures sufficient availability of funds
- Deals with the planning, organizing, and controlling of financial activities like the procurement and utilization of funds.



## Some Definitions:

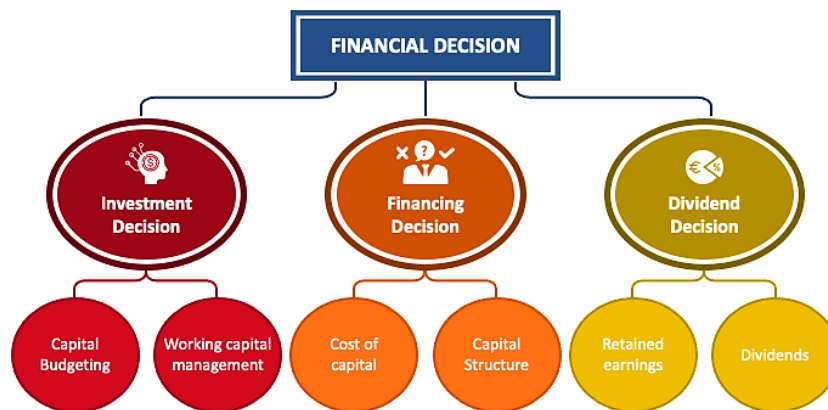
“Financial management is the activity concerned with planning, raising, controlling and administering of funds used in the business.”  
– *Guthman and Dougal*

## Objectives of Financial Management:

1. **Wealth Maximization:** The main objective of Financial management is to maximize shareholder's wealth, for which achievement of optimum capital structure and proper utilization of funds is a must.
2. **To procure sufficient funds for the organization:** Adequate and regular supply of funds is to be maintained for smooth operations of the business.
3. To ensure effective utilization of funds.
4. **To ensure safety of funds:** The chances of risk in investments should be minimum possible.
5. **To attain optimum capital structure:** A sound and economical combination of shares and debentures must be attempted so as to maintain optimum capital structure.



## Financial Decisions:



Every company is required to take three main financial decisions which are as follows:

1. **Investment Decision:** It relates to how the firm's funds are invested in different assets. Investment decision can be long-term or short-term. A long term investment decision is called capital budgeting decision as they involve huge amounts of funds and are irreversible except at a huge cost while short term investment decisions are called working capital decisions, which affect day to day working of a business.

### Factors affecting Investment Decisions/Capital Budgeting decisions:

- a) **Cash flows of the project:** The series of cash receipts and payments over the life of an investment proposal should be considered and analyzed for selecting the best proposal.
- b) **Rate of Return:** The expected returns from each proposal and risk involved in them should be taken into account to select the best proposal.
- c) **Investment Criteria Involved:** The various investment proposals are evaluated on the basis of capital budgeting techniques. These involve calculation regarding investment amount, interest rate, cash flows, rate of return etc.

2. **Financing Decision:** It relates to the amount of finance to be raised from various long term sources. The main sources of funds are owner's funds i.e. equity/shareholder's funds and the borrowed funds i.e. Debts. Borrowed funds have to be repaid at a fixed time and thus some amount of financial risk (i.e. risk of default on payment) is there in debt financing. Moreover, interest on borrowed funds has to be paid regardless of whether or not a firm has made a profit. On the other hand, shareholder's fund involves no commitment regarding payment of returns or repayment of capital. A firm mix both debt and equity in making financing decisions.

### Factors Affecting Financing Decision:

- a) **Cost:** The cost of raising funds from different sources are different. The cheapest source should be selected.
- b) **Risk:** The risk associated with different sources is different. More risk is associated with borrowed funds as compared to owner's fund as interest is paid on it and it is repaid also, after a fixed period of time or on expiry of its; tenure.
- c) **Flotation Cost:** The costs involved in issuing securities such as brokers commission, underwriters' fees, expenses on prospectus etc. are called flotation costs. Higher the flotation cost, less attractive is the source of finance.
- d) **Cash flow position of the business:** In case the cash flow position of a company is good enough then it can easily use borrowed funds and pay interest on time.
- e) **Control Considerations:** In case the existing shareholders want to retain the complete control of business then finance can be raised through borrowed funds but when they are ready for dilution of control over business, equity can be used for raising finance.

- f) **State of Capital Markets:** During boom, finance can easily be raised by issuing shares but during depression period, raising finance by means of debt is easy.
- g) **Period of Finance:** For permanent capital requirement, Equity shares must be issued as they are not to be paid back and for long and medium term requirement, preference shares or debentures can be issued.

Dividend refers to that part of the profit which is distributed to shareholders. A company is required to decide how much of the profit earned by it should be distributed among shareholders and how much should be retained. The decision regarding dividend should be taken keeping in view the overall objective of maximizing shareholder's wealth.

**Factors affecting Dividend Decision:**

- a) **Earnings:** Companies having high and stable earning could declare high rate of dividends as dividends are paid out of current and past earnings.
- b) **Stability of Dividends:** Companies generally follow the policy of stable dividend. The dividend per share is not altered and changed in case earnings change by small proportion or increase in earnings is temporary in nature.
- c) **Growth Prospects:** In case there are growth prospects for the company in the near future then it will retain its earning and thus, no or less dividend will be declared.
- d) **Cash Flow Positions:** Dividends involve an outflow of cash and thus, availability of adequate cash is for most requirement for declaration of dividends.
- e) **Preference of Shareholders:** While deciding about dividend the preference of shareholders is also taken into account. In case shareholders desire for dividend then company may go for declaring the same.
- f) **Taxation Policy:** A company is required to pay tax on dividend declared by it. If tax on dividend is higher, company will prefer to pay less by way of dividends whereas if tax rates are lower than more dividends can be declared by the company.
- g) **Issue of bonus shares:** Companies with large reserves may also distribute bonus shares to increase their capital base as it signifies growth of the company and enhances its reputation also.
- h) **Legal constraints:** Under provisions of Companies Act, all earnings can't be distributed and the company has to provide for various reserves. This limits the capacity of company to declare dividend.

**Financial Planning:**

The process of estimating the fund requirement of a business and specifying the sources of funds is called financial planning. It ensures that enough funds are available at right time so that a firm could honor its commitments and carry out its plans.





### Importance of Financial Planning:

1. To ensure availability of adequate funds at right time.
2. To see that the firm does not raise funds unnecessarily.
3. It provides policies and procedures for the sound administration of finance function.
4. It results in preparation of plans for future. Thus new projects can be undertaken smoothly.
5. It attempts to achieve a balance between inflow and outflow of funds. Adequate liquidity is ensured throughout the year.
6. It serves as the basis of financial control. The management attempts to ensure utilization of funds in tune with the financial plans.

### Capital Structure:

Capital structure refers to the mix between owner's funds and borrowed funds. It will be said to be optimal when the proportion of debt and equity is such that it results in an increase in the value of the equity share. The proportion of debt in the overall capital of a firm is called Financial Leverage or Capital Gearing. When the proportion of debt in the total capital is high then the firm will be called highly levered firm but when the proportion of debts in the total capital is less, then the firm will be called low levered firm.

### Factors Affecting Capital Structure:

1. **Trading on Equity:** It refers to the increase in profit earned by the equity shareholders due to the presence of fixed financial charges like interest. Trading on equity happens when the rate of earning of an organization is higher than the cost at which funds have been borrowed and as a result equity shareholders get higher rate of dividend per share.

The use of more debt along with the equity increases EPS as the debt carries fixed amount of interest which is tax deductible. Let us understand with an example:

	Company X	Company Y
Share Capital (or Rs. 10 each)	10,00,000	5,00,000
Debentures @ 10%		5,00,000
<b>Total Capital</b>	<b>10,00,000</b>	<b>10,00,000</b>
Earnings before int. and taxes (EBIT) @ 25% p.a.	2,50,000	2,50,000
Less tax (40%)	1,00,000	1,00,000
Profit after tax (available for equity shareholders)	1,50,000	1,50,000
No. of equity shares	1,00,000	1,00,000
Earnings per share	Rs. 1.50	Rs. 2.40

Thus the EPS of company Y is higher than company X because of application of 'Trading on equity'.

2. **Cash Flow Position:** In case a company has strong cash flow position then it may raise finance by issuing debts, as they are to be paid back after some time.
3. **Interest Coverage Ratio:** It refers to the number of times earnings before interest and taxes of a company covers the interest obligation. High Interest coverage ratio indicates that company can have more of borrowed funds. Formula for calculating ICR = EBIT/interest.
4. **Return on Investment:** If return on investment is higher than the rate of interest on debt then it will be beneficial for a firm to raise finance through borrowed funds.
5. **Floatation Cost:** The cost involved in issuing securities such as brokers' commission, under-writers' fees, cost of prospectus etc. is called floatation cost. While selecting the source of finance, floatation cost should be taken into account.

6. **Control:** When existing shareholders are ready to dilute their control over the firm then new equity shares can be issued for raising finance but in reverse situation debts should be used.
7. **Tax Rate:** Interest on debt is allowed as a deduction; thus in case of high tax rate, debts are preferred over equity but in case of low tax rate more preference is given to equity. Company X Company Y.
8. **Flexibility:** A good financial structure should be flexible enough to have scope for expansion or contraction of capitalization whenever the need arises. Issue of debenture and preference shares brings flexibility.
9. **Capital Market Conditions:** Conditions prevailing in capital market influences the determination of securities to be issued. Like during depression, people do not like to take risk and so are not interested in equity shares but during boom, investors are ready to take risk and invest inequity shares.

### Fixed Capital:

Fixed capital refers to investment in long-term assets. Investment in fixed assets is for longer duration and they must be financed through long-term sources of capital. Decisions relating to fixed capital involve huge capital funds and are not reversible without incurring heavy losses.



### Factors Affecting Requirement of Fixed Capital:

1. **Nature of Business:** Manufacturing concerns require huge investment in fixed assets & thus huge fixed capital is required for them but trading concerns need less fixed capital as they are not required to purchase plant and machinery etc.
2. **Scale of Operations:** An organization operating on large scale requires more fixed capital as compared to an organization operating on small scale. For Example - A large scale steel enterprise like TISCO requires large investment as compared to a mini steel plant.
3. **Choice of Technique:** An organization using capital intensive techniques requires more investment in plant & machinery as compared to an organization using labour intensive techniques.
4. **Technology upgradation:** Organizations using assets which become obsolete faster require more fixed capital as compared to other organizations.
5. **Growth Prospects:** Companies having more growth plans require more fixed capital. In order to expand production capacity more plant & machinery are required.



6. **Diversification:** In case a company goes for diversification then it will require more fixed capital to invest in fixed assets like plant and machinery.
7. **Distribution Channels:** The firm which sells its product through wholesalers and retailers requires less fixed capital.
8. **Collaboration:** If companies are under collaboration, Joint venture, then they need less fixed capital as they share plant & machinery with their collaborators.

### Working Capital:

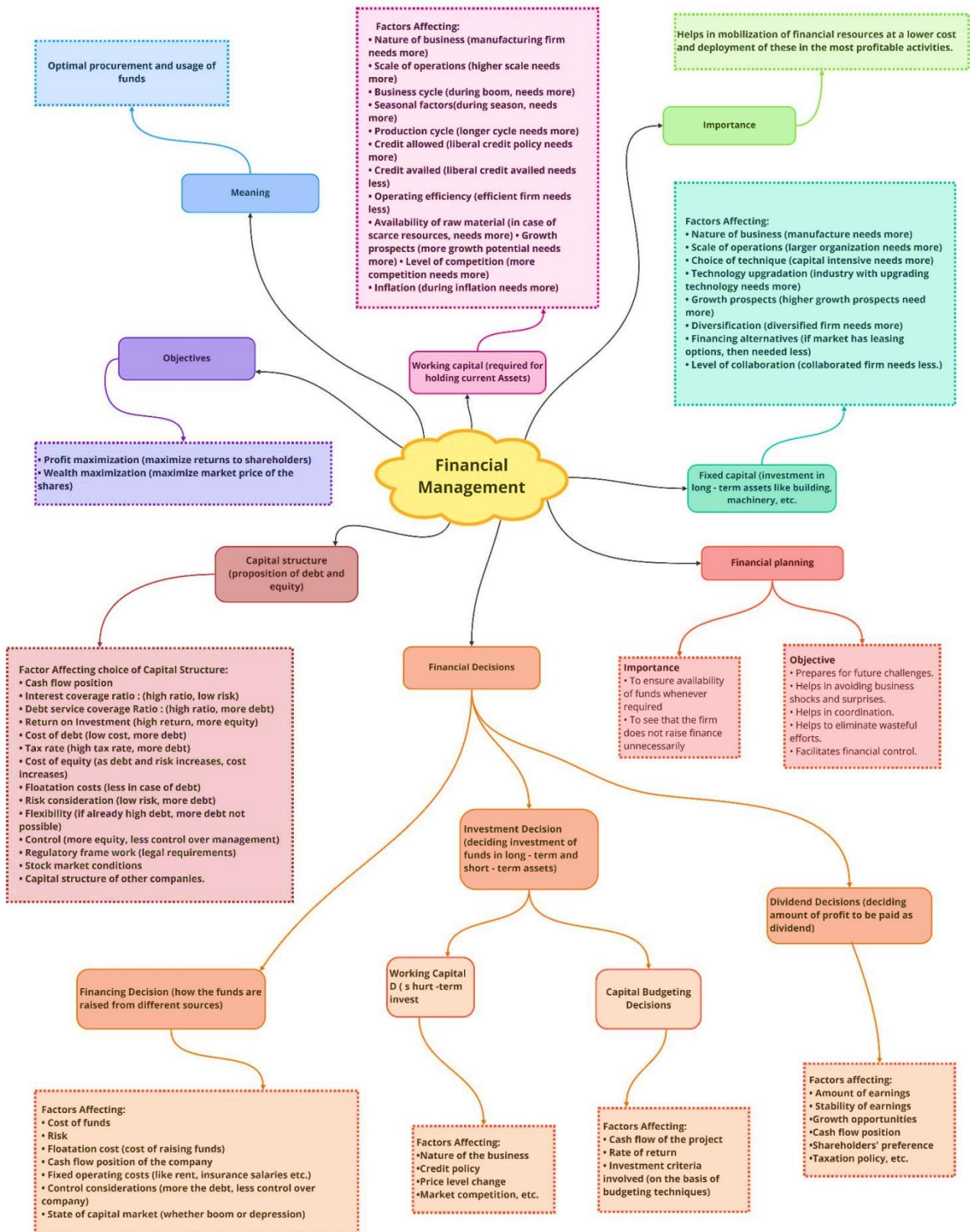
Working Capital refers to the capital required for day to day working of an organization. Apart from the investment in fixed assets every business organization needs to invest in current assets, which can be converted into cash or cash equivalents within a period of one year. They provide liquidity to the business. Working capital is of two types - Gross working capital and Net working capital. Investment in all the current assets is called Gross Working Capital whereas the excess of current assets over current liabilities is called Net Working Capital.

**Following are the factors which affect working capital requirements of an organization:**

1. **Nature of Business:** A trading organization needs a lower amount of working capital as compared to a manufacturing organization, as trading organization undertakes no processing work.
2. **Scale of Operations:** An organization operating on large scale will require more inventory and thus, its working capital requirement will be more as compared to small organization.
3. **Business Cycle:** In the time of boom more production will be undertaken and so more working capital will be required during that time as compared to depression.
4. **Seasonal Factors:** During peak season demand of a product will be high and thus high working capital will be required as compared to lean season.
5. **Credit Allowed:** If credit is allowed by a concern to its customers than it will require more working capital but if goods are sold on cash basis than less working capital is required.
6. **Credit Availed:** If a firm is able to purchase raw materials on credit from its suppliers than less working capital will be required.
7. **Inflation:** Working capital requirement is also determined by price level changes. For example, during inflation prices of raw material, wages also rise resulting in increase in working capital requirements.
8. **Operating Cycle/Turnover of Working Capital:** Turnover means speed with which the working capital is converted into cash by sale of goods. If it is speedier, the amount of working capital required will be less.



Class : 12th Business Studies  
Chapter-9 : Financial Management





## Important Questions

### Multiple Choice questions-

1. Higher debt-equity ratio results in:
  - (a) a Higher degree of financial risk
  - (b) a Higher degree of operating risk
  - (c) Higher EPS
  - (d) Lower financial risk
2. Cost of advertising and printing prospectus is called\_\_\_\_\_
  - (a) Floatation cost
  - (b) Debt cost
  - (c) Equity cost
  - (d) Dividend cost
3. The primary goal of the financial management is \_\_\_\_\_
  - (a) To maximize the return
  - (b) To minimize the risk
  - (c) To maximize the wealth of owners
  - (d) To maximize profit
4. Which of the following affects the Dividend Decision of a company?
  - (a) Taxation Policy
  - (b) Cash Flow Position
  - (c) Earnings
  - (d) All of the above
5. Which of the following affects capital budgeting decision?
  - (a) Investment Criteria and interest rate
  - (b) Rate of Return
  - (c) Cash Flow of the Project
  - (d) All of the above
6. Higher working capital usually results in:
  - (a) Higher equity, lower risk, and lower profits
  - (b) Lower current ratio, higher risk, and profits
  - (c) Lower equity, lower risk, and higher profits
  - (d) Higher current ratio, higher risk, and higher profits
7. Which of the following is not concerned with the Long term investment decision
  - (a) Management of fixed capital
  - (b) Inventory management
  - (c) Research and Development Programme
  - (d) Opening a new branch
8. Favourable financial leverage is a situation where \_\_\_\_\_
  - (a) ROI is higher than the rate of interest on debt
  - (b) ROI is Equal to the Rate of interest on debt
  - (c) ROI is lower than the rate of interest on debt
  - (d) None of the above
9. Other things remaining the same, an increase in the tax rate on corporate profits will:
  - (a) Make the debt relatively cheaper
  - (b) Make the debt relatively the dearer
  - (c) Have no impact on the cost of debt
  - (d) None of the above
10. Higher dividend per share is associated with:
  - (a) High earnings, high cash flows, stable earnings, and high growth opportunities
  - (b) High earnings, high cash flows, stable earnings, and lower growth opportunities
  - (c) High earnings, low cash flows, stable earnings, and lower growth opportunities
  - (d) High earning, high cash flows, unstable earnings, and higher growth opportunities
11. The main objective of financial planning is to ensure that\_\_\_\_\_
  - (a) Enough funds are available at the right time
  - (b) Dividend is paid to shareholders at the right time
  - (c) Purchase of raw material
  - (d) Purchase of fixed assets
12. Financial planning arrives at:
  - (a) Doing only what is possible with the funds that the firms have at its disposal
  - (b) Entering that the firm always have significantly more funds than required so that there is no paucity of funds
  - (c) Minimising the external borrowing by resorting to equity issues
  - (d) Ensuring that the firm faces neither a shortage nor a glut of unusable funds
13. Which of the following is not a financial Decision?
  - (a) Financing Decision
  - (b) Investment Decision
  - (c) Staffing Decision
  - (d) Dividend Decision

14. The cheapest source of finance is:
  - (a) Preference share
  - (b) Retained earning
  - (c) Equity share capital
  - (d) Debenture
15. Financial leverage is called favourable if:
  - (a) Return on Investment is lower than the cost of debt
  - (b) If the degree of existing financial leverage is low
  - (c) Debt is easily available
  - (d) ROI is higher than the cost of debt

### Very Short-

1. When is financial leverage considered favorable?
2. Why does financial risk arise?
3. How does production cycle effect working capital?
4. Enumerate two objectives of financial management?
5. What is the primary objectives of financial management?
6. What do you mean by floatation cost?
7. Name any two sources of long term fund?
8. What is Business Finance?
9. "A decision to acquire a new and modern plant to upgrade an old one". Identify the aspect of financial decision.
10. Are the share holders of a company likely to gain with a debt component in the capital employed ? Explain with the help of an example?

### Short Questions-

1. What are the various factors affecting Financial Planning?
2. Explain in brief the various steps in financial planning.
3. Explain the major characteristics or Principles of a sound financial plan.
4. Define the term 'Cost of Capital'. Also, explain the Significance of the cost of capital.
5. The board of Directors has asked you to design the capital structure of the company. Explain any sin factors that you would consider while doing so. 6

6. Every manager has to take three major decisions while performing the finance function. Explain them.
7. What do you call the capital needed for day to day operations? Explain any 5 factors affecting such capital needs.
8. The directors of a company have decided to expand their business activities by increasing the stock of raw materials and finished goods at an estimated cost of Rs. 50 lakhs, Describe the various ways open to the company to raise necessary finance for the purpose.
9. A capital budgeting decisions is capable of changing the financial fortune of a business. Do you agree? Why or why not?

### Long Questions-

1. Explain the various determinants of the financial needs of a business?
2. Define the term 'Over-Capitalisation' and 'Under Capitalisation' and their causes?

### Case Study Based Question-

1. Somnath Ltd. is engaged in the business of export of garments. In the past, the performance of the company had been upto the expectations. In line with the latest technology, the company decided to upgrade its machinery. For this, the Finance Manager, Dalmia estimated the amount of funds required and the timings. This will help the company in linking the investment and the financing decisions on a continuous basis. Dalmia therefore, began with the preparation of a sales forecast for the next four years. Fie also collected the relevant data about the profit estimates in the coming years. By doing this, he wanted to be sure about the availability of funds from the internal sources of the business. For the remaining funds he is trying to find out alternative sources from outside. (CBSE, Delhi 2017)

Identify the financial concept discussed in the above para. Also state the objectives to be achieved by the use of financial concept, so identified.

2. Ramnath Ltd. is dealing in import of organic food items in bulk. The company sells the items in smaller quantities in attractive packages. Performance of the company has been up to the expectations in the past. Keeping up with the



latest packaging technology, the company decided to upgrade its machinery. For this, the Finance Manager of the company, Mr. Vikrant Dhull, estimated the amount of funds required and the timings. This will help the company in linking the investment and the financing decisions on a continuous basis.

Therefore, Mr. Vikrant Dhull began with the preparation of a sales forecast for the next four years. He also collected the relevant data about the profit estimates in the coming years. By doing this, he wanted to be sure about the availability of funds from the internal sources. For the remaining funds he is trying to find out alternative sources.

Identify the financial concept discussed in the above paragraph. Also, state any two points of importance of the financial concept, so identified. (CBSE, OD 2017)

### Assertion Reason Question-

1. In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.
  - a. Assertion and reason both are correct statements and reason is correct explanation for assertion.
  - b. Assertion and reason both are correct statements but reason is not correct explanation for assertion.

- c. Assertion is correct statement but reason is wrong statement.
- d. Assertion is wrong statement but reason is correct statement.

**Assertion (A):** Capital budgeting decisions are very crucial and must be taken with utmost care.

**Reason (R):** Investment decisions affect the earning capacity of the firm over the long run and are irreversible except at a huge cost.

2. In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.
  - a. Assertion and reason both are correct statements and reason is correct explanation for assertion.
  - b. Assertion and reason both are correct statements but reason is not correct explanation for assertion.
  - c. Assertion is correct statement but reason is wrong statement.
  - d. Assertion is wrong statement but reason is correct statement.

**Assertion (A):** A company having easy access to the capital market follows a strict dividend policy.

**Reason (R):** Such a company can raise capital by approaching the capital market.

## Answer Key

### MCQ Answers-

1. **Answer:** (a) a Higher degree of financial risk
2. **Answer:** (a) Floatation cost
3. **Answer:** (c) To maximize the wealth of owners
4. **Answer:** (d) All of the above
5. **Answer:** (d) All of the above
6. **Answer:** (d) Higher current ratio, higher risk, and higher profits
7. **Answer:** (b) Inventory management
8. **Answer:** (a) ROI is higher than the rate of interest on debt

9. **Answer:** (a) Make the debt relatively cheaper
10. **Answer:** (b) High earnings, high cash flows, stable earnings, and lower growth opportunities
11. **Answer:** (a) Enough funds are available at the right time
12. **Answer:** (d) Ensuring that the firm faces neither a shortage nor a glut of unusable funds
13. **Answer:** (c) Staffing Decision
14. **Answer:** (b) Retained earning
15. **Answer:** (d) ROI is higher than the cost of debt

### Very Short Answers-

1. **Ans.:** Financial leverage is considered favourable when return on investment is higher than the cost of debt.
2. **Ans.:** Interest on borrowed fund have to be paid regardless of whether or not you firm has made a profit. Moreover, borrowed fund have to be repaid after a fixed time and it carries a charge on assets. This gives rise to financial risk.
3. working capital requirement is higher with longer production cycle.
4. **Ans.:** (a) To ensure availability of required funds.  
(b) to see that the firm does not raise resources unnecessarily.
5. **Ans.:** Wealth Maximisation.
6. **Ans.:** Cost uncured for raising funds.
7. (a) Debt.  
(b) Equity
8. **Ans.:** Money required for carrying out business activities is called business finance.
9. **Ans.:** Investment decision (Capital Budgeting).
10. **Ans.:** The shareholders of a company are very likely to gain with debt component in the capital employed by way of trading. On equity as it increases the earning per share (EPS) of the shareholders.

### Short Answers-

1. A financial plan should be prepared very carefully because it has a long-term impact on the working of an enterprise. A financial plan is affected by a number of factors. All these factors should be taken into consideration while preparing a financial plan.
  1. **Nature of Business:** The nature of business plays a decisive role in formulating a financial plan. A manufacturing business requires more amount of long-term funds than a trading business. In addition to it, the factors such as stability and regularity of income, future prospects of growth, seasonal fluctuations, assets structure, etc. affect the financial requirements as well as sources of finance.
  2. **Degree of Risk:** The risk involved in the business also plays an important role while planning the sources of finance. A firm

whose sales and earnings are subject to wide fluctuations runs the risk of not being able to meet the required payments in respect of interest and repayment of loans. Clearly, such firms should use more amount of their own funds and rely less on debt. On the other hand, the enterprises with stable sales and earnings can employ more amount of debts and hence can take the advantage of trading on equity.

3. **Standing of the concern:** Credit standing of concern among investors affects financial planning to a great extent. The credit standing of concern is determined by a number of factors such as the age of the firm, its past performance, size, market area, the reputation of management, etc.
4. **Plans for future Growth:** The plans for growth and expansion of the firm in near future are considered while formulating a financial plan. The financial plan should be developed in such a way as to facilitate required funds without much difficulty.
5. **Alternative Sources of Finance:** Since finance can be procured from a number of sources, the pros and cons of all the sources should be properly considered while choosing the proper sources of finance. The sources should be able to provide adequate funds to meet the requirements of the business.
6. **Attitude of Management:** The attitude of management towards risk and control of the business affects financial planning to a great extent. If the management is of risk-taking nature, it would employ more amount of borrowed funds. On the contrary, if it is of conservative nature it will employ more amount of equity capital. From the control point of view, if the management desires to keep full control of the enterprise, it will not issue fresh equity shares so that the new shareholders may not control the enterprises.
7. **Government Policies and Control:** The financial plan of a company is affected by the rules and regulations framed by the Government stock exchanges and financial institutions from time to time. The terms of



issue of shares and debentures, interest rates, dividend payments, etc. are governed by the rules framed by the government periodically. Permission of the Securities and Stock Exchange Board of India (SEBI) is also required for the issue of shares and debentures.

8. **Changes in Technology, Consumer Tastes, and Competitive Factors:** Rapid innovations are taking place in every field nowadays. A financial plan is adequately affected by changes in technology, consumer preferences, degree of competition, and general economic conditions.

2 Following steps should be taken for preparing a financial plan:

1. **Determination of Financial Objectives:**

For the purpose of preparing an effective financial plan first of all the financial objectives of a firm should be clearly determined. The financial objectives should be divided into short-term objectives as well as long-term objectives. The short-term objectives may include maintaining the liquidity of funds, maintaining the market standing of the firm and proper maintenance of sales, etc.

On the other hand, the long-term objectives may include the achievement of maximum efficiency of factors of production at minimum cost and the maximization of shareholder's wealth. The objectives should be clearly defined so that they can be used as guidelines for determining the 1 policies and procedures.

2. **Formulation of Financial Policies:** The second step in financial planning is the formulation of financial policies. Financial policies act as guidelines for the procurement, allocation, and effective utilization of funds of the organization. Financial policies are framed by the top management with the advice of the financial manager. The policies may be regarding capitalization, capital structure, trading on equity, fixed assets management, working capital management, dividend distribution, etc.

3. **Formulation of Procedures:** The policies laid down must be clarified in the form of detailed procedures. Each subordinate must know what he is required to do. Procedures are essential to ensure the consistency of actions. In financial procedures, financial executives decide about the control system, establish the standards of performance and compare the actual performance with the standards to ascertain the deviations and their causes. Thereafter, necessary steps are taken to control the deviations.

4. **Provision of Flexibility:** The objectives, policies, and procedures laid down as above constitute the financial plan of a business. Financial planning is a continuous process and hence there should be proper flexibility in the financial objectives, policies, and procedures so that these may be revised or thoroughly overhauled according to the changing circumstances.

3. An ideal financial plan must be based on the principles or qualities mentioned below:

1. **Simplicity:** Financial plan should be so simple that it may be easily understood by everyone. It should have a simple capital structure capable of being managed easily. The type of securities issued should be kept at a minimum because various types of securities will create unnecessary suspicion in the minds of investors.

2. **Foresight:** The financial plan should be prepared to keep in view the future needs of the business. It should take into consideration the future demand of the company's products, the future scale of operations, technological innovations, and various other changes. A financial plan should be able to meet the future requirements of fixed as well as working capital.

3. **Optimum use of Funds:** An ideal financial plan should always aim at the best possible and intensive use of all available resources of finance. The business should neither be starved of funds nor it should have a surplus or idle funds. Unnecessary idle funds are as bad as inadequate funds. A proper balance should also be kept between the short-term

and long-term funds of the business.

4. **Flexibility:** A financial plan should be sufficiently flexible. It should be possible for a company to change its financial plan with minimum cost and delay if warranted by changed circumstances. The company should be able to substitute one form of financing for another to economize the use of funds. The financial plan should allow a scope for adjustments as and when a new situation arises like recession, boom, etc. A rigid financial plan can easily become a burden rather than a technique of financial management.
  5. **Liquidity:** Liquidity is the ability of the enterprise to pay off its day-to-day expenses and other short-term liabilities on time. The financial plan should provide sufficient liquidity of funds as it will ensure the creditworthiness and goodwill of the enterprise. Adequate liquidity in the financial plan increases its flexibility also.
  6. **Economical:** Financial plan must be prepared in such a way that the cost of capital is minimum. The average cost of capital will be minimum when a fair balance is maintained between debt funds and owned capital. Also, the financial plan should involve minimum expenses on the issue of capital such as underwriting Commission, brokerage, etc.
  7. **Contingencies:** A financial plan should keep-in view the requirement of funds for contingencies. Contingencies mean the requirement of funds for unseen events.
  8. **Adequate system of Control:** A financial plan should establish and maintain a proper system of financial control.
  9. **Suitable to the Organisation structure:** A financial plan should be in accordance with the size and organizational structure of the firm.
4. The cost of capital of a firm is the minimum rate of return expected by its investors. The capital used by a firm may be in the form of equity shares, preference shares, debts, and retained earnings. The cost of capital is the weighted average cost of these sources of finance used by the firm. The concept of cost of capital occupies a

very important role in financial management because investment decisions are based on it. If a firm is not able to achieve its cost of capital the market value of its shares will fall.

**Definition:**

Cost of capital for a firm may be defined as the cost of obtaining the funds, i.e., the average rate of return that the investors in a firm expect, for investing funds in the firm.

It is also referred to as cut-off rate, target rate, hurdle rate, the minimum required rate of return, etc.

Some of the important definitions of cost of capital are stated below:

- *“The cost of capital is the minimum required rate of earnings or the cut-off rate of capital expenditures.”* – Ezra Salomon
- *“The cost of capital is the minimum rate of return which a firm requires as a condition for undertaking as an investment.”* – Milton H. Spencer
- *“Cost of Capital represents a cut-off rate for the allocation of capital to investments of projects. It is the rate of return on a project that will leave unchanged the market price of its securities.”* – James C. Van. Horne
- *“The Cost of Capital is the rate of return a company must earn on an investment to maintain the value of the company.”* – M. J. Fordon
- *“A firm’s so-called cost of capital – commonly expressed as an annual percentage figure – is simply that rate of return which its assets must produce in order to justify raising the funds to acquire them.”* – W. G. Lawpllen

Thus, on the basis of the above definitions, we can say that cost of capital is the minimum rate of return that a firm, must and, is expected to earn on its investments so as to maintain the market value of its shares.

**Significance of the Cost of Capital:** The concept of cost of capital is very important in making all the financial decisions of the firm. No financial decision is possible without the use of the cost of capital. Some important uses of cost of capital are:



1. **Helpful in Designing the Capital Structure:** The concept of cost of capital plays a vital role in designing the capital structure of a company. The capital structure of a company consists of different sources of capital such as equity capital, retained earnings. Preference capital and debt capital. These sources differ from each other in terms of their respective costs. As such a company will have to design such a capital structure that minimizes the cost of capital. Hence, the calculation of the cost of capital of different sources of capital is very essential to design an optimum capital structure.
2. **Helpful in taking Capital Budgeting Decisions:** Capital budgeting is the process of decision making regarding the investment of funds in long-term projects of the company. The concept of cost of capital is very useful in making capital budgeting decisions because the cost of capital is the minimum required rate of return on an investment project. Also, a firm must not invest in those projects which generate a return less than the cost of capital incurred for its financing.  
Net Present Value (NPV) and Internal Rate of Return (IRR) are two important methods used in capital budgeting. Both of these methods are dependent upon the use of the cost of capital. In the NPV method, a project is accepted if its NPV is positive. The project's NPV is calculated by discounting its cash flows at the cost of capital rate. Under the IRR method, the cost of capital is used as a minimum required rate of return. Hence, the cost of capital serves as a decision criterion for taking capital budgeting decisions.
3. **Helpful in Evaluation of Financial Efficiency of Top Management:** The concept of cost of capital can be used to evaluate the financial efficiency of top management. Such an evaluation will involve a comparison of the projected overall cost of capital with the actual cost of capital incurred by the management. Lower the actual cost of capital better is the financial performance of the management of the firm.
4. **Helpful in Comparative Analysis of Various Sources of Finance:** Cost of capital to be raised from various sources goes on changing from time to time. Calculation of cost of capital is helpful in the analysis of the usefulness of various sources of finance. A particular source of finance may be encouraged or discouraged on the basis of its changed cost.
5. **Helpful in taking other Financial Decisions:** The cost of a capital concept is also useful in making other financial decisions such as dividend policy, rights issue, working capital decisions, and capitalization of profits.
5. For design the capital structure of the company six factors are as following:-
  - 1) Cash Flow Position.
  - 2) Interest coverage ration(ICR)
  - 3) Debt Service coverage ratio(DSCR)
  - 4) Return on investment (ROI)
  - 5) Cost of debt
  - 6) Tax rat
6. A manager take three following major decisions:-
  - 1) Financing Decision.
  - 2) Investment Decision.
  - 3) Dividend Decision.
7. Capital needed for day to day operations is called working capital. explain any 5 factors affecting such capital needs.
  - 1) Nature of business
  - 2) Scale of operations
  - 3) Seasonal Factors
  - 4) Production cycle
  - 5) Credit allowed
8. The company can raise necessary finance for the purpose of expansion through the following function.
  - (a) Issue of shares
  - (b) Issue of debentures
  - (c) Loans from banks and financial institutions.
  - (d) Retained earnings.
9. Hint Yes, I agree to this statement because of the following importance of capitals budgeting decisions.



- (a) Long term growth and effects.
- (b) Large amt of funds involved
- (c) Risk involved
- (d) Irreversible decisions.

### Long Answers-

#### 1. Determination of Financial Needs of a Business

or

##### Assessing Funds Requirements

Estimating or determining the financial requirements of the business is one of the main objectives of financial planning. Before raising funds, it is essential that the requirement of funds be correctly estimated. In the absence of correct estimates, the firm may suffer either from inadequate or surplus funds. If the funds are short of its requirements, the firm will not be able to meet its day-to-day expenses and pay the short-term and long-term liabilities on time.

On the other hand, if the funds are in excess of the requirements of the business, they will remain idle and will reduce the profitability of the business. Hence, the estimates should be made in a way that all financial requirements are properly satisfied.

Funds requirements of a business can broadly be classified into two main categories. They are:

1. Fixed Capital Requirements, and
2. Working Capital Requirements.

**Assessment of Fixed Capital Requirements:** Fixed capital is the capital that is meant for fulfilling the permanent or long-term needs of the business. In the words of Shubin, "Fixed capital is the funds required for the acquisition of those assets that are to be used over and over for a long period."

Fixed capital is required for acquiring fixed assets. Fixed assets may include the following:

1. Tangible assets such as land, buildings, plant and machinery, furniture, etc.
2. Intangible assets such as goodwill, patents, copyrights, etc.

A certain amount of fixed capital is also required for meeting certain expenditures not leading to the creation of an asset like research expenses, promotional expenditure incurred for the establishment of business, share issue expenses, underwriting commission, etc. The requirement

of funds for these expenditures is long-term and hence the funds required in respect thereof are also included under fixed capital.

Every business needs a fair amount of fixed capital to be invested in fixed assets so as to create production or business facilities. For a new business, the fixed capital is needed in the beginning because fixed assets are needed at the time of promoting or establishing the business. For an existing business fixed capital is required for the development and expansion of the business. Hence, it is essential to have an adequate amount of fixed capital in the business.

The assessment of fixed capital requirements for a new business can be made by preparing a list of fixed assets needed by the business.

The list is prepared by the promoters by studying similar units and by taking advice from technical experts. The estimation of cost of land can be made from property dealers, estimation regarding the cost of building can be made with the help of building contractors and the cost of machinery can be ascertained from the suppliers of the machinery. Similarly, the amount to be paid for goodwill, patents, trade-marks, etc. can also be estimated.

**Factors Affecting the Estimation of Fixed Capital/Fixed Assets Requirements:** Factors that affect the estimation of Fixed Capital or Fixed assets requirements can be studied under two heads

- (a) Internal Factors and
- (b) External Factors.

#### (a) Internal Factors:

1. **Nature of Business:** Certain types of businesses require heavy investment in fixed assets, while others do not. Usually, the manufacturing concerns require more fixed assets than trading concerns. Similarly, public utility undertakings like railway, electricity, water supply, etc. require huge funds to be invested in fixed assets.
2. **Size of Business:** Larger the size of a concern, the greater will be the requirement of fixed capital. Also, in larger concerns, most of the activities are performed with the help of



automatic machines. As such, they require a huge investment in fixed assets.

3. **Types of Products:** A concern that manufactures simple consumer products such as soap, oil, etc. will need a lesser amount of fixed capital in comparison to a concern that manufactures complicated products such as motorcycles, cars, etc.
4. **Activities Undertaken by the Enterprise:** A concern that is engaged in the manufacturing of all parts of a product by itself will require a greater amount of fixed capital as compared to a concern that gets most of the parts manufactured from outside and merely assembles them. Similarly, if a concern itself manufactures and markets its products, it will require more amount of fixed capital as compared to a concern that is engaged only in the manufacturing or only in marketing activities.
5. **Mode of Acquisition of Fixed Assets:** If some of the fixed assets are available on the lease or on hire, a lesser amount of fixed capital will be required. On the contrary, if all the fixed assets are to be purchased on immediate cash payment, a larger amount of fixed capital will be needed.
6. **Acquisition of Old Assets:** In certain industries, old plant and machinery may be available at sufficiently reduced prices and which can be used 'satisfactorily'. It would reduce the requirement of fixed capital to a great capital to a great extent. But the old plant and machinery should be used in the industries where the technological changes are moderate or slow.
7. **Availability of Fixed Assets of Concessional Rate:** In some areas, the Government provides land and other equipment at concessional rates to promote balanced industrial growth. In such a case, the requirement of fixed capital is reduced.

#### (b) External Factors:

1. **General Economic Outlook:** If the economy is recovering from depression and the level of business activity is expected to rise, the requirement for fixed assets will also rise and hence the need for fixed capital will also rise.
2. **Technological Changes:** If rapid technological innovations are taking place in an industry, the need for fixed capital will be larger because the old and out-dated machinery will have to be replaced by new ones.
3. **Degree of Competition:** The degree of Competition also affects the Fixed Capital-requirements. If there is a lot of competition in some industries, the need for fixed capital will be more because if some firms go on adopting the new technology, the others have to follow them.
4. **Shift in Consumer Preferences:** If the consumer preferences go on changing in some industries, the need for fixed capital will be more because the firm will have to produce new varieties accordingly, which require more investment in fixed assets.

**Assessment of Working Capital Requirements:** After the assessment of fixed Capital, funds required for working capital are assessed. The term 'Working Capital' is used in two ways.

In one sense it denotes the 'total current assets' whereas in another sense it is regarded as the excess of current assets over current liabilities. Current assets include cash, receivables (i.e., debtors and bills receivables), stock, etc. The amount required to be invested in current assets differs from one business to another. The amount depends on various factors such as nature and size of the business, duration of the production cycle, rapidity of turnover, credit policy, the quantity of stock, seasonal fluctuations, rate of growth, etc.

Working capital may be fixed or fluctuating. Fixed working capital refers to the minimum amount which would always be invested in raw materials, work-in-progress, finished goods, receivables,

and cash balance. This amount is absolutely essential throughout the year on a continuous basis to maintain a desirable level of business activity. The amount required for fixed working capital mainly depends on the duration of the production cycle.

The cycle starts from the purchase of raw material; then the raw material is converted into finished goods by incurring labor and other costs. On sale, these finished goods are converted into debtors and lastly, the firm will again have cash when the debtors pay. The length of the production cycle (i.e., the length of time between the purchase of raw material and receiving cash from debtors) will determine the quantum or requirements of fixed working capital. The longer the cycle, the higher will be the requirements of fixed working capital.

The requirement of working capital over and above the fixed working capital is known as fluctuating working capital. It keeps on fluctuating from time to time according to the change in the level of business activities. For instance, during peak season, due to intensive sales, more funds are blocked in stocks and debtors and thus more amount will be required for fluctuating working capital.

The total amount of working capital can be estimated by estimating the needs of working capital for the following:

1. For maintaining adequate stock
2. For receivables.
3. For paying day-to-day expenses
4. For contingencies

1. **For maintaining adequate stock:** Every industrial undertaking is required to maintain a minimum stock of raw materials, work in progress, and finished goods. The requirement of the stock is determined by various factors like volume of production, the length of the production cycle, and the period for which the finished goods have to remain in a warehouse before they are sold.
2. **For receivables:** Finished goods may be sold for cash or on credit. Credit sales take the form of receivables (i.e., debtors and bills receivables). The amount is tied up in receivables until cash is realized from them.

The amount tied up in receivables depends upon a number of factors such as quantum of credit sales, credit period allowed, the efficiency of the debt collection system, etc. For example, if a firm changes its credit period from 30 days to 60 days, the amount tied up in debtors will go up, and consequently, the need for working capital will also increase by a similar amount.

3. **For paying day-to-day expenses:** A firm has to carry some minimum cash balance to make payment for wages, salaries, and other expenses throughout the year. A proper cash balance is also maintained to avail of the cash discounts facilities offered by proper cash balance is also maintained to avail of the cash discounts facilities offered by the suppliers.
4. **For contingencies:** A minimum cash balance is also maintained for meeting unseen contingencies so that the business successfully sails through the period of crisis.

Thus, the overall financial needs of a business can be determined, by assessing the needs for fixed capital and working capital separately and then by adding the two.

2. **Over Capitalisation:** Quiet often, the term 'Over-Capitalisation' is misunderstood to mean the excess of capital. But in actual practice, over-capitalized concerns have been found short of funds.

In fact, over-capitalization refers to that state of affairs where a company earns less than what should have earned at a fair rate of return on the capital invested in it. In other words, if a company is continuously unable to earn a fair rate of return on its capital, it is termed an over-capitalized company.

In the words of Bonneville Dewey, "When a business is unable to earn a fair rate of return on its outstanding securities, it is over-capitalised."

According to Gerstenberg, "A corporation is over-capitalized when its earnings are not large enough to yield a fair return on the number of stocks and bonds that have been issued or when the amount of securities outstanding exceeds the current value of assets."



The same view has been expressed by Harold Gilbert in these words, "When a company has consistently been unable to earn the prevailing rate of return on its outstanding securities (considering the earning of similar companies in the same industry and the degree of risk involved) it is said to be over-capitalized."

It is clear from the above definitions that the situation of over-capitalisation arises due to a fall in the earning capacity of the business. On account of this, the earnings will not be sufficient to give a reasonable return on capital employed in it. For example, a company is earning a profit of Rs. 8,00,000 on a total capital investment of Rs. 80,00,000. In case the normal, rate of return prevailing in the market is 10%, this company will be said to be fairly capitalized. However, if it earns only Rs. 2,20,000 while the normal rate is 10%, the company will be said to be over-capitalized because it will be able to give a return of only 6% on the total capital employed.

In order to ascertain whether a company is earning a fair return or not, the rate of return earned by the company should be compared with similar firms in that industry. If the company's rate of return is substantially less than the average rate earned by other firms, will indicate that the company is unable to earn a fair return on the capital employed in it. It may also be noteworthy that a company will be said to be over-capitalized only when it is continuously unable to earn fair income over a long period of time. If its earning is reduced temporarily, owing to the occurrence of abnormal events like strikes, lockouts, etc. the company will not be called over-capitalized.

#### Causes of Over-Capitalisation:

Following are some of the important causes of over-capitalization:-

1. **Over-Issue of Capital:** If a company raises more capital than it can profitably use, there will be a large number of idle funds will the company. Because of idle funds, the earning capacity of the company will be reduced. This leads – to the situation of over-capitalization because the company will have to pay dividends on idle capital too. Hence, the rate of dividend will fall which in turn leads to a fall in the market price of its shares.

2. **Promotion of the Company with Inflated Assets:** A company will fall prey to over-capitalization if it is promoted with assets purchased at excessive prices, the reason is that such prices of the assets do not bear any relation to their earning capacity. Such a situation arises particularly when a partnership firm or private company is converted into a public company and in that process, their assets may be transferred to the public company at price higher than their real values. Sometimes, the promoters also transfer their property to the new company at inflated prices.
3. **Promotion or Expansion of the Company during Boom Period:** If a company is formed or expanded during the boom period, it may become a victim of over-capitalization. The reason is that the price paid for assets will be quite high. When the boom disappears the real value of such assets will decline to a great extent whereas they will be shown in the books at their original values. Such a company is over-capitalized because its earning will fall due to depression but the assets and capital will be shown in the books in previous figures.
4. **High Promotion Expenses:** A certain degree of over-capitalization may be caused due to the fact that the promoters have incurred heavy expenses on the promotion of the company, a huge amount may have been spent on issue and underwriting of shares and the promoters may have taken a fabulous remuneration for the services rendered by them. A major part of the earnings of the company will be utilized to write off these expenses and consequently, the company will not be able to pay fair dividends on its shares.
5. **Over-estimation of Earnings at the Time of promotion:** In case of a new concern, the amount of capitalization is determined on the basis of estimates of future earnings. However, if it is found that the actual earning is less than the estimated earning, it will lead to a situation of over-capitalization. For example, if a company's annual earnings were estimated at Rs. 50,000 and its current rate of return (or N capitalization rate) is 10% its, capitalization will be fixed at Rs. 5,00,000. Subsequently, it was found that the company actually earned (Rs. 40,000. On this basis, the company's capitalization should have been: fixed at Rs. 4,00,000. Thus, the company will be over-capitalized by Rs. 1,00,000.

6. **Under-estimation of Rate of Return at the Time of Promotion:** A concern may have correctly estimated the number of its earnings, but it may have under-estimated its rate of return (i.e., capitalization, rate). For example, a company's annual earnings were estimated at 'Rs. 50,000 and the rate of return were fixed at 10%. By applying this rate the company's capitalization was worked out at Rs. 5,00,000. Subsequently, it was found that the actual rate of return was 12.5%, and hence the amount of capitalization should have been fixed at Rs. i.e.,  $Rs. 50,000 \times 100.12.5$  Obviously, there is over-capitalization to the extent of Rs.1,00,000.
7. **Shortage of Capital:** Sometimes, the shortage of capital may also lead to over-capitalization. It may happen when the promoters underestimate the requirements of capital and raise less capital in relation to the needs of the business. In such a case the company will be forced to borrow a large sum of money at an unreasonably high rate of interest. A major part of the earnings will be absorbed by the amount of interest, leaving little for the shareholders. This will bring down the value of shares leading to over-capitalization.
8. **Inadequate Depreciation:** If a company does not make sufficient provisions for depreciation and replacement of assets, it will find after some time that the earning capacity of the assets is diminished leading to a fall in its earnings. This is yet another case of over-capitalization.

**Under-capitalization:** The term 'under-capitalization' does not mean a shortage or inadequacy of capital. The term is just reverse to over-capitalization. In the words of Greenberg:

"A corporation may be under-capitalized when the rate of profits, it is making on total Capital, is exceptionally high in relation to the return enjoyed by similarly situated companies in the same industry, or when it has too little capital with which to conduct its business."

In simple words, under-capitalization is a state of affairs when the capital or resources of the company are being utilized more efficiently. As a result, the company succeeds in continuously earning an abnormally high rate of return on the capital employed in it. Such a company declares a high rate of dividend in comparison to the prevailing rate and the market value of its shares exceeds their book value. Thus under-

capitalization refers to the sound financial position and good management of the company.

#### **Causes of Under-Capitalisation:**

The following are the important causes of under-capitalization:

1. **Under-Estimation of Capital Requirements:** At the time of promotion, the promoters may underestimate the capital requirements of the company. This results in a situation of under-capitalization at later stages when more capital is required.
2. **Under-Estimation of Earnings:** Sometimes at the time of promotion, the future earnings of the company are under-estimated and the company is capitalized accordingly. If afterward it is found that the actual earnings are far in excess of the estimates, the company may find itself in a situation of under-capitalization.
3. **Over-Estimation of Rate of Return at the Time of Promotion:** Sometimes a concern estimates its income correctly but it over-estimates its rate of return (i.e., capitalization rate). For example if a company's earnings were estimated at Rs. 60,000 and the rate of earnings were fixed at 15%. By applying this rate the capitalization was fixed at Rs. 4,00,000 (i.e.,  $Rs. 60,000 \times 15$ ). Subsequently, it was ascertained that the actual rate was 10% and hence the amount of capitalization should have been Rs. 6,00,000 (i.e.,  $Rs. 60,000 \times 10$ ). Thus, the company is under-capitalized by Rs. 2,00,000.
4. **Promotion of Company During Deflation:** Companies that are floated under recessionary conditions often experience under-capitalization after the recession is over. This is because of two reasons. Firstly, during recession assets are purchased at a price that is must lower in comparison to their earning capacity. Secondly, companies established during a recession are capitalized at a low figure anticipating low earnings but when the recession is over earnings increase and the company becomes under-capitalized.
5. **Conservative Dividend Policy:** Certain companies follow a policy of declaring low dividends and plowing back a major part of their earnings. They build up large funds for replacement, renovation, and expansion. The result of such a policy is reflected in high earnings which is a situation of under-capitalization.



6. **High Level of Efficiency:** In a company where the management is very efficient, the company may operate on a high efficiency even with a meager amount of capital. Over a period, earning the position of the company will improve and it will become under-capitalized.

### Case study Answer-

1. **Answer:**

Financial planning is the financial concept discussed in the above paragraph. The process of estimating the fund requirements of a business and specifying the sources of funds is called financial planning. It relates to the preparation of a financial blueprint of an organisation's future operations. The objectives to be achieved by the use of financial concept are stated below:

- To ensure availability of funds whenever required which involves estimation of the funds required, the time at which these funds are to be made available and the sources of these funds.
- To see that the firm does not raise resources unnecessarily as excess funding is almost as bad as inadequate funding. Financial planning ensures that enough funds are

available at right time.

2. **Answer:**

- a. Financial planning is the financial concept discussed in the above paragraph. The process of estimating the fund requirements of a business and specifying the sources of funds is called financial planning. It relates to the preparation of a financial blueprint of an organization's future operations.
- b. The two points highlighting the importance of planning are described below:
  - It ensures smooth running of a business enterprise by ensuring availability of funds at the right time.
  - It helps in anticipating future requirements of a funds and evading business shocks and surprises

### Assertion Reason Answer-

1. a. Assertion and reason both are correct statements and reason is correct explanation for assertion.
2. d. Assertion is wrong statement but reason is correct statement.



STEP UP  
ACADEMY

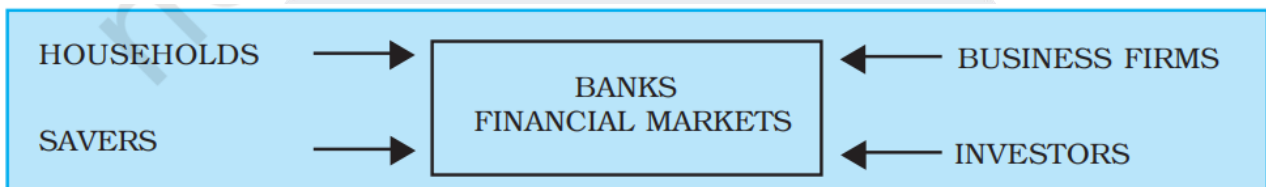
# Financial Market | 10

## Introduction:

Financial Intermediation = process of allocating funds from saving surplus units (E.g. households) to saving deficit units (e.g. industries, government etc.)

Alternatives = Banks or Financial markets

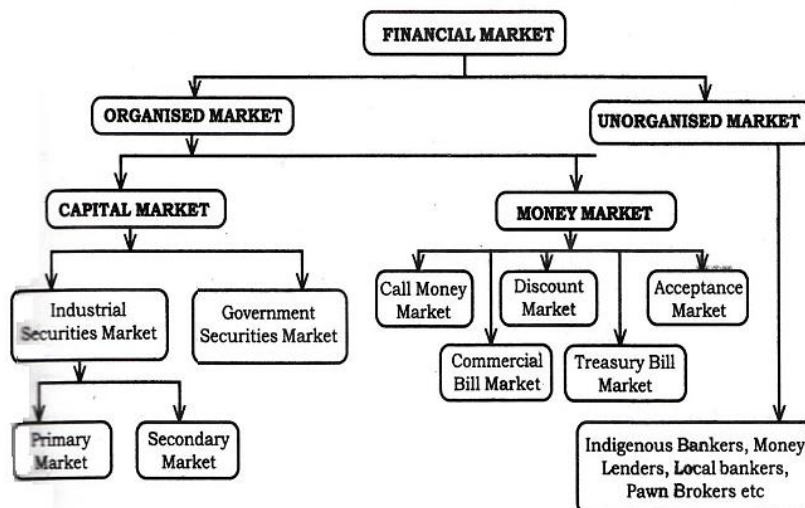
Financial Markets are the institutional arrangements by which savings generated in the economy are channelized into avenues of investment by industry, business and the government. It is a market for the creation and exchange of financial assets.



## Functions of Financial Market:

- Mobilization of savings:** It is an allocative function of financial market that it facilitates transfer of people's saving to investors.
- Price fixation:** price is determined from the forces of demand and supply. The interaction between demand and supply helps to establish a price for financial asset.
- Provides liquidity to financial assets:** shareholders can sell their share easily through mechanism of financial market.
- Reduce the cost of transactions:** provides valuable information to buyers and sellers of financial assets & helps in saving time money and efforts.

## Types of Financial Markets:





## Money Market:

It is a market for short term funds/securities whose period of maturity is up to one year. The major participants in the money market are RBI, Commercial Banks, Non-Banking Finance Companies, State Government, Large Corporate Houses and Mutual Funds.

**The main instruments of money market are as follows:**

1. **Treasure Bills:** They are issued by the RBI on behalf of the Central Government to meet its short-term requirement of funds. They are issued at a price which is lower than their face value and are repaid at par. They are available for a minimum amount of Rs.25000 and in multiples thereof. They are also known as Zero Coupon Bonds. They are negotiable instruments i.e. they are freely transferable.
2. **Commercial Paper:** It is a short term unsecured promissory note issued by large credit worthy companies to raise short term funds at lower rates of interest than market rates. They are negotiable instruments transferable by endorsement and delivery with a fixed maturity period of 15 days to one year.
3. **Call Money:** It is short term finance repayable on demand, with a maturity period of one day to 15 days, used for interbank transactions. Call Money is a method by which banks borrow from each other to be able to maintain the cash reserve ratio as per RBI. The interest rate paid on call money loans is known as the call rate.
4. **Certificate of Deposit:** It is an unsecured instrument issued in bearer form by Commercial Banks & Financial Institutions. They can be issued to individuals, Corporations and companies for raising money for a short period ranging from 91 days to one year.
5. **Commercial Bill:** It is a bill of exchange used to finance the working capital requirements of business firms. A seller of the goods draws the bill on the buyer when goods are sold on credit. When the bill is accepted by the buyer it becomes marketable instrument and is called a trade bill. These bills can be discounted with a bank if the seller needs funds before the bill maturity.

## Capital Market:

It is a market for long term funds where debt and equity are traded. It consists of development banks, commercial banks and stock exchanges.

**The capital market can be divided into two parts:**

1. Primary Market.
2. Secondary Market.

**Primary Market:** It deals with the new securities which are issued for the first time. It is also known as the New Issue Market. The investors in this market are banks, financial institutions, insurance companies, mutual funds and individuals. It has no fixed geographical location and only buying of securities takes place in the primary market.

**Methods of Floatation of New Issues in Primary Market:**

1. **Offer through Prospectus:** It involves inviting subscription from the public through issue of prospectus. A prospectus makes a direct appeal to investors to raise capital through an advertisement in newspapers and magazines.
2. **Offer for Sale:** Under this method, securities are offered for sale through intermediaries like issuing houses or stock brokers. The company sells securities to intermediary/broker at an agreed price and the broker resells them to investors at a higher price.
3. **Private Placements:** It refers to the process in which securities are allotted to institutional investor and some selected individuals.
4. **Rights Issue:** It refers to the issue in which new shares are offered to the existing shareholders in proportion to the number of shares they already possess.
5. **e-IPOs:** It is a method of issuing securities through an on-line system of stock exchange. A company proposing to issue capital to the public through the on-line system of the stock exchange has to enter into an agreement with the stock exchange. This is called an e-initial public offer. SEBI's registered brokers have to be appointed for the purpose of accepting applications and placing orders with the company.



**Secondary Market:** It is also known as the stock market or stock exchange where purchase and sale of existing securities takes place. They are located at specified places and both the buying as well as selling of securities takes place.

### Difference between Primary Market and Secondary Market:

Basis	Primary Market	Secondary Market
Securities	Only new securities are traded	Existing securities are traded
Price of Securities	Prices of securities are determined by the management of the company.	Prices are determined by the forces by the demand and supply of the securities.
Purchase and Sale	Securities are sold to investors directly by the company or through intermediary.	Investors exchange ownership of securities.
Place of Market	There is no fixed geographical location.	Located at specified places.
Medium	Only buying of securities takes place.	Both buying and selling of securities can take place.

### Stock Exchange/Share Market:

A Stock Exchange is an institution which provides a platform for buying and selling of existing securities. It facilitates the exchange of a security i.e. share, debenture etc. into money and vice versa.

**Following are some of the important functions of a Stock Exchange:**

1. **Providing liquidity and Marketability to Existing Securities:** Stock Exchange provides a ready and continuous market for the sale and purchase of securities.
2. **Pricing of Securities:** Stock Exchange helps in constant valuation of securities which provide instant information to both buyers and sellers and thus helps in pricing of securities which is based on the forces of demand & supply.
3. **Safety of Transaction:** The members of a stock exchange are well regulated, who are required to work within the legal framework. This ensures safety of transactions.
4. **Contributes to Economic Growth:** Stock exchange provides a platform by which savings get channelized into the most productive investment proposals, which leads to capital formation & economic growth.
5. **Spreading of Equity Culture:** Stock exchange helps in educating public about investments in securities which leads to spreading of Equity culture.
6. **Providing Scope for Speculation:** Stock exchange provides scope within the provisions of law for speculation in a restricted and controlled manner.

### Trading Procedure on a Stock Exchange:

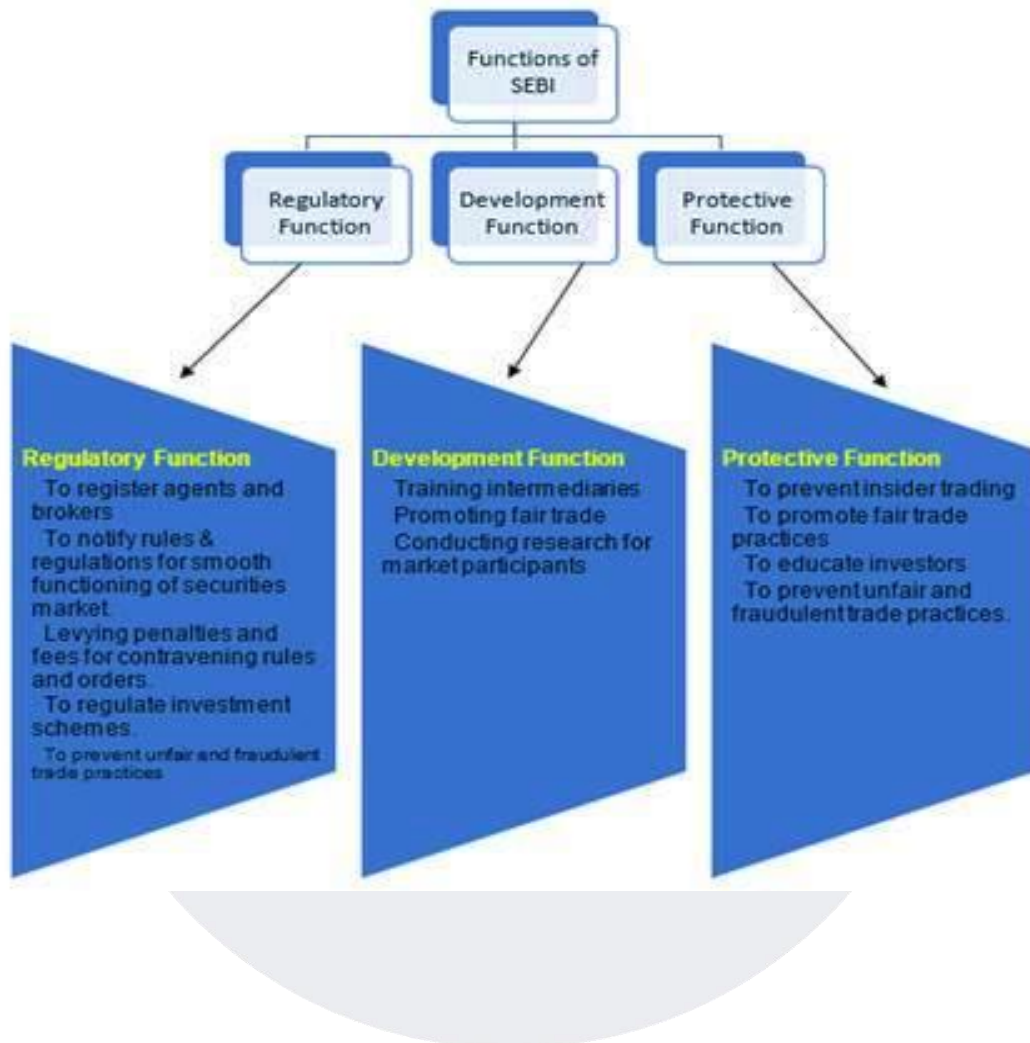
1. **Selection of Broker:** in order to trade on a Stock Exchange first a broker is selected who should be a member of stock exchange as they can only trade on the stock exchange.
2. **Placing the order:** After selecting a broker, the investors specify the type and number of securities they want to buy or sell.
3. **Executing the order:** The broker will buy or sell the securities as per the instructions of the investor.
4. **Settlement:** Transactions on a stock exchange may be carried out on either cash basis or carry over basis (i.e. badla). The time period for which the transactions are carried forward is referred to as accounts which vary from a fortnight to a month. All transactions made during one account are to be settled by payment for purchases and by delivery of share certificates, which is a proof of ownership of securities by an individual. Earlier trading on a stock exchange took place through a public outcry or auction system which is now replaced by an online screen based electronic trading system. Moreover, to eliminate, the problems of theft, forgery, transfer, delays etc. an electronic book entry from a holding and transferring securities has been introduced, which is called process of dematerialization of securities.



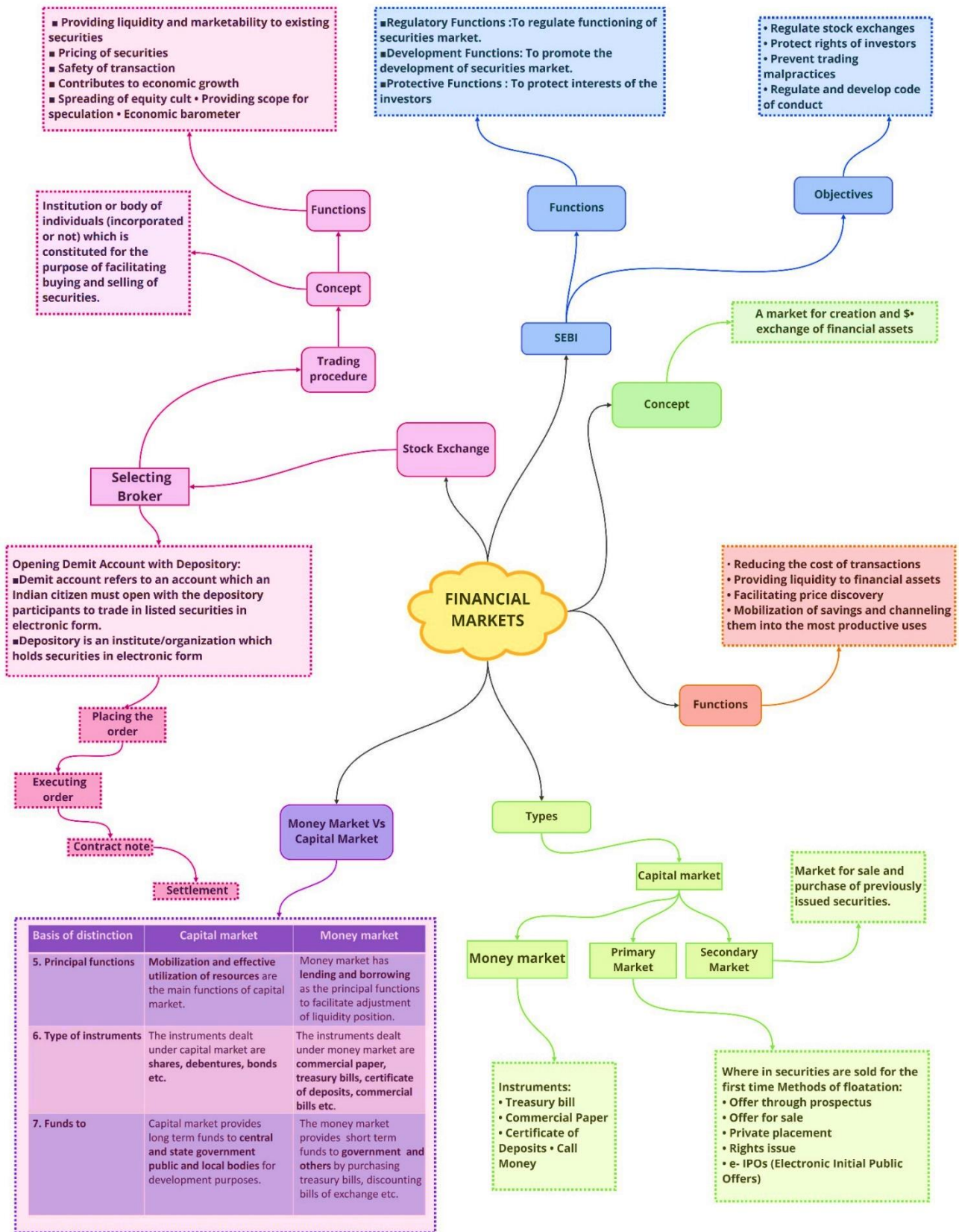
## Objectives of SEBI:

1. To regulate stock exchange and the securities market to promote their orderly functioning.
2. To protect the rights and interests of investors and to guide & educate them.
3. To prevent trade mal practices such as internal trading.
4. To regulate and develop a code of conduct and fair practices by intermediaries like brokers, merchant bankers etc.

## Functions of SEBI:



Class : 12th Business Studies  
Chapter-10 : FINANCIAL MARKETS





## Important Questions

### Multiple Choice Questions-

- Treasury bills are also known as \_\_\_\_\_
  - Fixed interest Bonds
  - Low-Interest Bonds
  - Flat Rate Bonds
  - Zero-Coupon Bonds
- Which of the following is a method of floatation?
  - Offer for sale
  - Private Placement
  - Offer through the prospectus
  - All of the above
- Primary and secondary markets:
  - Control each other
  - Complement each other
  - Compete with each other
  - Function independently
- The total number of Stock Exchanges in India is:
  - 22
  - 21
  - 23
  - 20
- Money market deals in \_\_\_\_\_
  - Long term Securities
  - Medium-term securities
  - Short term Securities
  - None of the above
- A Treasury Bill is basically:
  - An instrument to borrow short-term funds
  - An instrument to borrow long-term funds
  - An instrument of capital market
  - None of the above
- What is meant by Demat Account?
  - Development Market Account
  - Depository Participant Account
  - Dematerialisation of Securities
  - Demand Depository Account
- To be listed on OTCEI, the minimum capital requirement for a company is:
  - Rs. 10 crores
  - Rs. 3 crores
  - Rs. 25 crores
  - Rs. 5 crores
- Clearing and settlement operations of NSE are carried out by:
  - NSDL
  - SBI
  - NSCCL
  - CDSL
- Instruments traded in capital market are \_\_\_\_\_
  - Bonds
  - Equity Shares and Preference Shares
  - Debentures
  - All of the above
- OTCEI was started on the lines of:
  - NSE
  - NYSE
  - NASDAQ
  - NASDAQ
- \_\_\_\_\_ is not a participant in money market
  - SEBI
  - NBFCs
  - RBI
  - Mutual Funds
- When a trade bill is accepted by a commercial bank, it is known as a \_\_\_\_\_
  - Certificate of deposit
  - Commercial Bill
  - Call money
  - None of the above
- What type of instruments are traded in a Money Market?
  - Treasury bills
  - Commercial bills
  - Call money
  - All of the above
- Capital market deals in \_\_\_\_\_
  - Medium and long term securities
  - Very short term securities
  - Short term securities
  - None of the above

### Very Short-

1. Name the kind of issue in which shares are offered to existing shareholder.
2. Give example of any two financial intermediaries.
3. Give examples of any two money market instruments.
4. What was the traditional system of trading on a stock exchange?
5. What are the two basis on which transactions on a stock exchange may be carried out?
6. Give names of any two places where regional offices of SEBI is located.
7. What is the settlement cycle in NSE.

### Short Questions-

1. The director of a newly established company having paid up equity share capital of 25 crores desire to get its shares traded at all India Level Stock exchange. As finance Manager of the company, Suggest the name of stock exchange for the purpose. Give any 3 reasons in support of your answer.
2. The director of a company want to modernize its plants and machinery by making a public issue of Shares. They wish to approach stock exchange, while the finance manager prefers to approach a consultant for the new public issue of shares. Advice the directors whether to approach stock exchange or a consultant for new public issue of shares. Advise the directors whether to approach stock exchange or a consultant for new public issue of shares and why? Also advise about the different methods which the company may adopt for the new public issue of shares.
3. The directors of a newly established company having a paid up equity share capital of Rs 25 crores, desire to get its shares traded at an all India level stock exchange. As finance manager of the company, suggest the name of the stock exchange for the purpose. Give any 3 reasons in support of your answer.
4. Explain the concept of the Financial Market?
5. Explain the term, Capita
6. Mention, in brief, the classification of the financial market?
7. Give the meaning of various terms used in the stock market in India?
8. Explain the meaning of the stock-market Index?
9. Explain the term Listing of securities and mention its advantage.

10. Explain the role of the new issue market in the investment business.

### Long Questions-

Question 1. What is Stock Market? Mention its nature and functions.

Question 2. Explain the various risks attached to investment?

### Case Study based Question-

1. Meca Ltd. a reputed automobile manufacturer needs Rupees ten crores as additional capital to expand its business. Atul Jalan, the CEO of the company wanted to raise funds through equity. On the other hand the Finance Manager, Nimi Sahdev said that the public issue may be expensive on account of various mandatory and non-mandatory expenses. Therefore, it was decided to allot the securities to institutional investors.

Name the method through which the company decided to raise additional capital. (CBSE, Delhi 2017)

2. These days, the development of a country is also judged by its system of transferring finance from the sector where it is in surplus to the sector where it is needed most. To give strength to the economy, SEBI is undertaking measures to develop the capital market. In addition to this there is another market in which unsecured and short-term debt instruments are actively traded everyday. These markets together help the savers and investors in directing the available funds into their most productive investment opportunity.

a. Name the function being performed by the market in the above case.

b. Also, explain briefly three other functions performed by this market. (CBSE, Delhi 2017)

### Assertion Reason Question-

1. In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.

a. Assertion and reason both are correct statements and reason is correct explanation for assertion.



- b. Assertion and reason both are correct statements but reason is not correct explanation for assertion.
- c. Assertion is correct statement but reason is wrong statement.
- d. Assertion is wrong statement but reason is correct statement.

**Assertion (A):** Instruments of the money market are close substitutes for money.

**Reason(R):** Discount Finance House of India provides a ready market for money market instruments.

2. In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.

- a. Assertion and reason both are correct statements and reason is correct explanation for assertion.
- b. Assertion and reason both are correct statements but reason is not correct explanation for assertion.
- c. Assertion is correct statement but reason is wrong statement.
- d. Assertion is wrong statement but reason is correct statement.

**Assertion (A):** Treasury Bills are considered negotiable instruments.

**Reason (R):** Treasury Bills have assured yield and negligible risk of default due to the soundness of RBI.

## Answer Key

### MCQ Answers-

1. **Answer:** (d) Zero-Coupon Bonds
2. **Answer:** (d) All of the above
3. **Answer:** (b) Complement each other
4. **Answer:** (b) 21
5. **Answer:** (c) Short term Securities
6. **Answer:** (a) An instrument to borrow short-term funds
7. **Answer:** (c) Dematerialization of Securities
8. **Answer:** (b) Rs. 3 crores
9. **Answer:** (c) NSCCL
10. **Answer:** (d) All of the above
11. **Answer:** (c) NASDAQ
12. **Answer:** (a) SEBI
13. **Answer:** (b) Commercial Bill
14. **Answer:** (d) All of the above
15. **Answer:** (a) Medium and long term securities

### Very Short Answers-

1. **Ans.** Right Issue.
2. **Ans.** a) Banks. b) Financial markets.
3. **Ans.** a) Commercial Paper. B) Call Money.
4. **Ans.** Outcry or auction system
5. **Ans.** Cash basis or Carry over basis.

6. **Ans.** a) Chennai b) Delhi
7. **Ans.** T+2

### Short Answers-

1. **Ans.** The company should get its share listed at OTCEI. The main features of OTCEI are the following-
  - 1) Nation-wide listing, Listing on one exchange one can have transactions with all the counters in the whole country.
  - 2) Exclusive list of companies, on the OTCEI only those companies are listed whose issued capital is 30 Lakh or more.
  - 3) Investor's registration- All the investor doing transactions on the OTCEI have got to register themselves compulsorily.
  - 4) Transparency in transactions- All the transactions are done in the presence of the investor. The rates of buying and selling can be seen on the computer screen.
2. **Ans.** the directors should approach the consultant for the new public issue of shares as the company wish to make new public issue of shares to modernize its plants and machinery. Following are the methods which the company may adopt for the new public issue of shares:

- i) **Right Issue:** Since it appears from the question that the company is an existing company as it wants to modernize its plant and machinery, the company by statute is required to offer these shares first to the existing shareholders in proportion to their holdings. If the existing shareholders do not take these shares then company can resort to other methods as given below.
  - ii) **Public Offer through Prospectus:** Under this method, the company can directly offer its shares to the public at large after issuing prospectus.
  - iii) **Offer for sale:** In this case, an intermediary buys all the shares from the company at agreed price and offers it to the investors at a higher rate.
  - iv) **Private Placement:** In this case also an intermediary buys the shares from the company but offers it to only a selected few for sale.
3. **Ans.** In the given situation, I would recommend the shares of the company to be listed at the outlet the counter exchange of India(OTCEI). The reasons are:
- i) In the OTCEI, there is an existence of compulsory market makers (banks/financial institutions) that buys/sells securities of the selected companies which improves the liquidity of the securities.
  - ii) The Company has a paid-up share capital of less than Rs 3crores. iii) Less stringent conditions are applicable for listing of the securities as compared to those applicable for listing in National Stock exchange of India.
4. **Ans.** Concept of Financial Market: A business is a part of an economic system that consists of two main sectors – households that save funds and business firms which invest these funds. A financial Market helps to link the savers and the investors by mobilizing funds between them. In doing so it performs what is known as allocative functions. It allocates or directs funds available for investment into their most productive investment opportunity. When the allocative function is performed well, two consequences follow

- The rate of return offered to households would be higher.
- Scarce resources are allocated to those firms which have the highest productivity for the economy;

There are two major alternative mechanisms through which allocation of funds can be done: via banks or via financial markets. Households can deposit their surplus funds with banks, who in turn could lend these funds to business firms. Alternately, households can buy the shares and debentures offered by a business using financial markets. The Process by which allocation of funds is done is called intermediation. Banks and Financial Markets are competing intermediaries in the financial system, and give households a choice of where they want to place their savings.

A financial market is a market for the creation and exchange of financial assets. Financial markets exist wherever a financial transaction occurs. Financial transactions could be in a fourth of creation of financial assets such as the initial issue of share and debenture by a firm or the purchase and sale of existing financial assets like equity share debenture and bonds.



l Market?

5. **Ans. Capital Market:** The term Capital Market refers to facilities and institutional arrangements through which long-term funds, both debt and equity are raised and invested. It consists of a series of channels through which savings of the community are made available for industrial and commercial enterprises and for the public in general. It directs these saving into their most productive use leading to the growth and development of the economy. The capital market consists of development banks, commercial banks, and stock exchanges.

An ideal Capital Market is one where finance is available at a reasonable cost. The process of economic development is facilitated by the existence of a well functioning capital market. In, the fact the development of the financial system is seen as a necessary condition for economic growth. It is essential that financial institutions

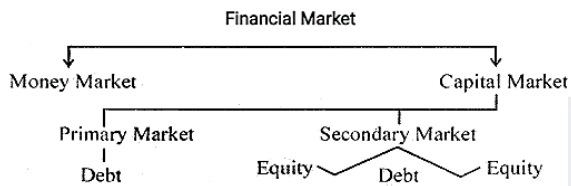


are sufficiently developed and that market operations are free, fair, competitive, and transparent. The capital market should also be efficient in respect of the information that it delivers, minimize transaction costs and allocate capital to most productivity.

The Capital Market can be divided into two parts:

1. Primary Market
2. Secondary Market.

6. **Ans.** Classification of financial market



Financial Markets are classified on the basis of the maturity of financial instruments traded 'in them. Instruments with a maturity of less than one year are traded in the money market. Instruments with longer maturity are traded in the capital market.

7. **Ans.** Various terms used in the stock market: The following terms in magazines or newspapers when you read about the stock market.

**Bourses:** Bourses is another word for the Stock Market.

**Bulls and Bears:** The term does not refer to animals but to the market sentiment of the investors. A bullish phase refers to a period of optimism and a bearish phase to a period of pessimism on the bourses.

**Badla:** This refers to a carry forward system of settlement, particularly at the BSE. It is a facility that allows the postponement of the delivery or payment of a transaction from one settlement period to another.

ODD lot Trending Trading in multiples of 100 stocks or less.

Penny Stocks These are securities that have no value on the stock exchange but whose trading contributes to speculation.

8. **Ans. Stock Market Index:** A stock market index is a barometer of market behavior. It measures overall sentiment through a set of stocks that are representative of the market. It reflects the market direction and indicates day-to-day fluctuations in stock prices. An ideal index must represent a change in the prices of securities and

reflect price movements of typical share for better market representation. In the Indian markets, the BSE SENSEX and NSE NIFTY are important indices. Some important global stock market indices are:

- Dow Jones Industrial Average is among the oldest quoted stock market index in the US.
- NASDAQ composite index is the market capitalization weights of prices for a stock listed in the NASDAQ Stock Market.
- S and P 500 index is made up of the 500 biggest publicly traded companies in the US. The S and P 500 is often treated as a proxy for the US stock market.
- FISE 100 consists of the largest 100 companies by full market value listed on the London Stock Exchange. The FISE 100 is the benchmark index of the European market.

9. **Ans.** Listing of Securities: A security is said to be 'listed' when its name is added to the list of securities in which trading on a particular exchange is permitted. The principal objectives of listing are

1. to provide ready marketability and free negotiability to stocks and shares;
2. to ensure proper supervision and control of dealings therein; and
3. to protect the interests of shareholders and of the general investing public.

**Advantages of Listing:**

The advantage of listing may be viewed from two angles

1. from the point of view of the management of companies; and
2. from the point of view of the shareholders.

The advantages derived by the management as a result of listing are many. A part of the distinct advertising value, listing enables the management to broaden and diversify shareholding. It is the general, consensus of opinion that a company with broad-based share ownership is better suited for growth and stability than a company with shares concentrated in few hands. Ensuring thus a broadening of share ownership, listing not only brings a company's shares to the attention of hundreds and thousands of new investors but also encourages institutional investors to be



interested in them. It helps the company to gain national importance and widespread recognition.

There is a difference between a listed and non-listed security (particularly from the point of view of the psychological motivation of the investors in applying for subscription to shares) in as much as Section 73 of the Companies Act required that every company intending to offer shares or debentures to the public for subscription through the issue of a prospectus, must seek enlistment with one or more stock exchanges. If such listing is not granted or applied for then the company must return all money to the applicants.

This, in other words, implies that prospective listing prompts the investors to apply for the shares and failure to secure listing entitles the investors to claim a refund of the money. In fact, the listing has tremendous value to a company in regard to the raising of additional capital for expansion or other purposes.

Section 81 of the Companies Act provides that any further issue of the share unless waived by them in a general meeting, must in the first instance be offered to the existing shareholders, the company concerned will be in great difficulty, and will also have to incur great expense in selling them. But in the case of a listed company, there is neither this difficulty nor the additional expenses, for this right can be disposed of by the shareholders through the Stock Exchange.

Further, when a listed company makes such an offer of further shares to the shareholders, the shareholders in their turn get a better estimation of the value of the shares from the price at which the shares of the company are quoted on the stock exchange. Listing, thus affords a great advantage to the management in ensuring a saving in the cost of raising new capital. This additional business or assets or mergers with the companies because listing enables it to offer its securities in exchange for those of a closely held or of an unlisted company.

The shareholders or investors derive manifold benefits if the shares held or owned by them are listed on the Stock Exchange. The main benefits are

1. It affords liquidity to their holding.
2. It affords them to obtain the best prices for the securities if they want to sell-off.

3. It helps them to avoid the botheration of canvassing from door to door to sell the securities and more telephonic or verbal orders to a stockbroker will help them to buy or sell listed security.

4. Transactions of the Stock Exchange are done by auction bids, so there is no hide or seek about the price at which the investor buys or sells the share.

5. The Stock Exchange quotation helps the investors to keep themselves abreast of the price changes of the securities owned or held by them.

6. The investors get maximum protection in regard to their holding, because the Stock Exchange rules and regulations have been formulated with the end in view.

7. Listing is also advantageous in the matter of income-tax, wealth-tax, estate, duty, and other taxes payable by shareholders in their capacity as assesses. However, from the foregoing discussion, it should not be concluded that the Stock Exchange vouches for the listed securities. In fact, Price determination and value judgments involve constant scrutiny and assessment of each company from business, financial, accounting, legal and technical points of view, and there are primarily the functions of the buyers and sellers in the market.

The Stock Exchange cannot and does not stand sponsor for the listed securities or guarantee their investment value, but it does ensure continuing sponsorship and assistance in the establishment and development of sound and progressively higher standards of corporate practice and procedure. For these reasons, listing carries the hallmark of prestige and confers on the listed company, its securities, and its shareholder a privileged position.

8. Listing gives an added collateral value to the securities held by investors, for the bank in making loans and advances prefer security quoted on the Stock Exchange.

10. **Ans.** Role of the New Issue Market: The analysis of the role of the new issue market in financing companies can be undertaken by the study of the statistics of the annual volume of the new issues. The data may be broken down in various ways,



for example, according to the type of security issued, the kind of organization making the issue, the method of flotation of the issue, and so on.

The Reserve Bank of the organization making the issue, the method, for instance, has been following this method in its regular studies of capital issues in the private corporate sector. However, this approach is partial, and to that extent, an inadequate method of appraisal in that 'it does not explain the full significance of the role of the New Issue Market.

1. Its first shortcoming is that the technique to aggregate the amount of all prospectus and right issues, to arrive at the new issues made in a particular year does not reveal the true picture as the entire sum is not necessarily raised by the issuing companies from the investing public in the same year because they are collected through various calls which may be spread over five years. This, of course, is a minor point.
2. The method presents absolute figures, unrelated to the use to which these funds are put.
3. The method leads to the treatment of the New Issue Market in isolation from the rest of the capital market and consequently to a distorted view as to its real functions.
4. Further, it does not disclose as to what kind and size of firms are obtaining funds, nor at what cost they are doing so, and, therefore, gives no clue as to efficiency to explore such questions, obviously, a different approach is necessary.

Another approach that tries to remedy the weaknesses of the first, is the source-and-use-of-funds approach of analysis of company balance sheets. In this connection, two possibilities suggest themselves.

- (a) A possible method is to make a direct comparison between new issues and industrial fixed capital formation, but this suffers from a serious limitation to the extent it is based on the simple assumption that long-term source of funds ought roughly to match long-term investment, for it is not virtually impossible for the analysts to relate the sums raised on the market to the uses that are made of those funds by the

organization making those, issues, but it is also misleading to link specific sources of funds to a specific use.

True, investment intangible fixed assets in the most important long-term use of funds but is certainly not only important use to which funds are put when a group of companies is expanding output. The expenditure on fixed assets is, therefore not a good yardstick to measure the importance of capital issues. It is particularly misleading when studying different industries in which the relative importance of investment in stock and in fixed assets varies considerably.

What is needed is a much wider and more comprehensive approach in order to get the different sources and uses of funds into perspective. However, since it is not always possible to have the correct data forthcoming, we have to make use of that which is available.

### Long Answers-

1. **Ans.** Stock Markets in India: Stock exchanges are intricately interwoven in the fabric of a nation's economic life. Without a stock exchange the saving of the community – the sinews of economic progress and productive efficiency – would remain under-utilized. The tasks of mobilization and allocation of savings could be attempted in the old days as a much less specialized institution than the Stock Exchange.

But as business and industry expanded and the economy assumed a more complex nature, the need for "permanent finance", arose. Entrepreneurs needed money for the long term whereas investors demanded liquidity – the facility to convert their investments into cash at any given time. The answer was a ready market for investments and this was how the Stock Exchange came to being.

Stock Exchange means any body of individuals, whether incorporated or not, constituted for the purpose of regulating or controlling the business of buying, selling, or dealing in securities. These securities include

1. Shares, Scrips, Stock, bonds, debentures stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

2. Government securities; and
3. Rights or interest in Securities.

**Nature and function of Stock Exchange:**

There is an extraordinary amount of ignorance and of prejudice born out of ignorance with regard to the nature and functions of the stock, exchange. As economic development proceeds, the scope for acquisition and ownership of capital by private individuals also groups.

Along with it, the opportunity for the Stock Exchange to render the service of stimulating private savings and channeling such savings into? productive investment exists on a vastly great scale. These are services which the stock exchange alone can render efficiently, it is no exaggeration to say that in a modern industrialist society, which t recognizes the rights of private ownership of capital, stock exchanges are not simply a convenience, they are essential, In fact, they are the markets which exist to facilitate purchase and sale of securities of companies and the securities or bonds issued by the govt, in the course of its borrowing operation.

As our country moves towards liberalization, this tendency is certain to be strengthened. The task % facing the stock exchanges is to devise the means to reach down to the masses, to draw the savings as the man in the street into productive investment, to create conditions in which many millions of little 'investors in cities, towns, and villages will find it possible to make use of the facilities, which have so far been limited to the privileged few. This calls for far-reaching changes, institutional as well as operational.

The Stock Exchanges in India, thus, have an important role to play in the building of a real shareholder's democracy. The aim of the Stock Exchange authorities is to make it as nearly perfect in the social and ethical sense as it is in the economic. To protect the interests of the investing public, the authorities of the stock exchanges have been increasingly subjecting not only its members to a high degree of discipline but

also those who use its facilities – joint-stock companies and other bodies in whose stocks and shares it deals.

There are stringent regulations to ensure that directors of joint Stock companies keep their shareholders fully informed of the affairs of the companies before their shares are listed are more rigorous and wholesome than the statutory provisions such as those contained in the Companies Act.

Apart from providing a market that mobilizes and distributes that nation's savings, the Stock Exchange ensures that the flow of savings is utilized for the best purpose from the community's point of view. 'Free' markets are not simply a matter of many buyers and sellers. If the prices at which stocks and shares change hands are to be 'fair' prices, many important conditions must be satisfied. It is the whole vast company of investors, competing with one another as buyers and sellers, this decides what the level of security prices shall be.

But the public is prone to sudden savings of hope and fear. If left entirely to itself, it could produce needlessly violent and-often quite irrational fluctuations. The professional dealers of the stock of these movements. These are valuable activities. So as to ensure that the investors reap the full benefiting them, they need to be regulated by a recognized code of conduct. Fair prices and free markets require, above all things, clean dealings both by professionals and by the investors – and dealings based upon up-to-date and reliable information, easily accessible to all.

Thus, a free and active market in stock and shares has become a pre-requisite for the mobilization and distribution of the nation's savings on the scale needed to support modern business. The Stock Exchange by a process of prolonged trial and error, which is by no means complete, has been continually streamlining its structure to meet these wide and ever-growing responsibilities to the public. The activities of the Stock Exchange to the public.



The activities of the Stock Exchange are governed by a recognized code of conduct apart from statutory regulations. Investors, both actual and potential, are provided, through the daily stock exchange price quotations, with an up-to-the-minute approval of the present worth of their holdings, in the light of all the influences that affect the position and prospectus of the companies in question. But the Stock Market does not determine the health of the company, it merely reflects it. It is a thermometer, not a fever.

The prices are sometimes distorted by excessive speculation but, by and large, they provide a continuous assessment of the current value of assets, not available to those who invest in houses or land or other assets, not traded on the Stock Exchange. In fact, whether our demand for a stock is motivated by income or profits, so long as it is related to a corporation, the prices of the securities markets will play 'a realistic part in determining the corporation's ability to raise funds.

For those enterprises that must finance externally, the receptivity of the market to their offerings establishes both the volume and cost of capital raised. For those companies that finance the bulk of their requirements through reinvested earnings, the willingness of Stockholders to defer dividends in the expectation of a higher return through capital gains establishes both the volume and cost of the capital raised. If a company's outlook is very promising and buyers bid up the security's market value new financing becomes easier whether through? external or internal sources – the earnings prices ratio is reduced, and the cost of capital becomes correspondingly low.

However, the capacity, of a business to raise fresh capital for the approved purposes by selling shares to the public, and the cost of capital to the borrower, do not depend simply or even mainly upon the intrinsic merits of the business. They depend upon the public's estimate of the investment merits of its share in comparison with those

of other comparable securities. But these relative investment merits are measured very largely by the prices at which the new securities are offered and the comparable existing securities quoted in the market.

More precisely, they are determined by the relative's yields, actual or prospective, that can be obtained in interest or dividends on the capital sum that these market prices represent. The cost of a company or raising new capital is not the price at which the new shares are sold to investors, but the effective rate of interest field that has to be offered in order to secure it. Other things being equal, investors will readily accept a lower interest yield for a progressive and promising company than they will demand from a slow-moving and inefficient one.

The tremendous important and socially useful service that the stock exchange renders to the industries is with regard to the shifting of the burden of financing from the mgt. to those of the investor. It will be realized more so from the fact that there is always a conflict of motives between the industries and the investors. Industries require long-term finance, with the end in view of looking it up in land, buildings, plants, etc. Investors, on the other hand, have liquidity preference, that is to say, they want to get back the money or and when they would need it.

In other words, while the industries require permanent finance, the investors can tend it only for a while because the money that they led to the industries comes from their savings which are made for future spending over contingencies. It is not merely the individual investors alone who suffer from the 'liquidity' preference complex institutional investors to have the same motive.

It is generally thought that a Stock Exchange serves only those who have money to invest and securities to sell. But a stock benefits the whole community in a variety of ways. By enabling producers to raise capital, it indirectly gives employment to millions of people and helps consumers to get the goods needed by them.

Again, all those who save, put their money either in banks or in life insurance, invest in buying shares and securities, are also helped by stock exchanges, because the institutions with which they place their savings avail themselves of the services of the exchange to invest the money collected by them.

It is efficient from the foregoing analysis that the ready liquidity and constant evaluation of assets, together with a range of available investments act as a powerful inducement to save and invest and draw the savings of the community into the channels which are expected to be most productive. It would be difficult to find a more effective method of doing this.

In addition, the overall trend of prices and volume of business on the stock exchange serve as an economic barometer which faithfully registers the changing events and opinion about the investment outlook. Even allowing for the aberrations of speculation, % this mirror of the investment scene is one that neither economists nor businessmen nor the govt, charged with the formulation of economic policy, can afford to ignore.

2. **Ans.** There are many risks attached to the investment, which are as follows:

1. **Business and Financial Risk:** Business risk and financial risk are actually two separate types of risks, but since they are interrelated it would be wise to discuss them together. Business risks, which is sometimes called operating risk, is 'the risk associated with the normal day-to-day operations of the firm.

Financial risk is created by the use of fixed cost securities. Looking at the two categories in sources and uses, Context, business risk represents the chance of loss and the variability of return created by a firm's uses of funds. Financial risk is the chance of loss and the variability of the owner's return created by a firm's sources of funds.

To clarify this imp. distinction between business and financial risk, let us examine the income statement contained in the exhibit. Earnings before interest and taxes

can be viewed as the operating profit of the firm, the profit of the firm before deducting financing charges and taxes.

Business risk is concerned with earnings before interest and taxes and financial risk is concerned with earnings available to equity holders. The two components of business risk signify the chance that the firm will fail because of the inability of the assets of the firm to generate a sufficient level of earnings before interest and the variability of such earnings.

The two components of financial risk reflect the chance that the firm will fail because of the inability, to meet interest and principal payments on debt, and the variability of earnings available to equity holders caused by fixed financing charge. Putting it in another way, this second component of financial risks is the extent to which earnings available to equity holders will vary at a greater rate than earnings before interest and taxes. In case the firm does not employ debt, there will be no financial risk.

An imp. aspect of financial risk is the interrelationship between financial risk and business risk. In effect, business risk is basic to the firm, but the firm's risk can be affected by the amount of debt financing used by the firm. Whatever be the amount of business risk associated with the firm the firm's risk will be increased by the use of debt financing.

As a result, it follows that the amount of debt financing used by the firm should be determined by the amount of business without fear of default, or a market impact on the earnings available to the equity shareholders. Conversely, if the firm faces a lot of business risk, then the use of a lot of debt financing may jeopardize the firm's future operations.

2. **Purchasing power Risk:** Whenever investors desire to preserve their economic position over time, they utilize investment outlets whose values vary with the price level. They select investments whose market values change with consumer prices which compensates them for the cost-of-



living increase. If they do not, they will find that their total wealth has been diminished. Inflation is an economic crippler that destroys the economic power of investors over, goods and services.

In essence, investors have to be concerned with the command that their invested money has over goods and services on a continuing basis. In fact, we have been living with increasing consumer prices for many years.

3. **Market Risks:** This hazard arises from the fact that market prices and collateral values of securities and real property may vary substantially, even when their earning power does not change. The causes of these price uncertainties are varied. At times many markets are simply thin—that is, buyers and sellers, appear only intermittently. More commonly, investment prices vary because investors vacillate in their preference for different forms of investment, or simply because they sometimes have money to invest and sometimes do not have it. But once the equity has developed a particular price pattern, it does not change this pattern quickly. The causes of changes in market price are usually beyond the control of the corporation.

An unexpected war or the end of one, an election year, political activity, illness or death of a President, speculative activity in the market, the outflow of bullion – all are tremendous psychological factors in the market. The irrationality in the securities markets may cause by the general tenor of the market any called market risks.

The market risk in equity shares is much greater than it is in bonds. Equity share value and prices are related in some fashion to earning. Current and prospective dividends, which are made possible by earnings, theoretically, should be capitalized at a rate that will provide yields to compensate for the basic risks, on the other hand, bond prices are closely related to changes in interest rates on new debt. Equity prices are affected primarily by financial risk considerations which, in turn, affect earnings and dividends.

However, equity prices may be strongly influenced by mass psychology, by abrupt changes in financial sentiment, and by waves as optimism or presses. Whenever emotions run high, speculators and gamblers crave action. They cannot refrain from entering the market arena as their greed for profits becomes their overpowering motivation. They do not hesitate to analyze the market environment. They do not base their judgment on an accurate evaluation of the underlying factors. Instead, do not base their judgments on an accurate evaluation of the semblance of value. Greed pushes-price up and fear drives them down.

In short, the crux of the market risk is the likelihood of incurring. Capital losses from price changes engendered by speculative psychology.

4. **Interest Rate Risk:** A major source of risk to the holders of high-quality bonds changes in interest rates, commonly referred to as interest rate risk. These high-quality bonds are not subjected to either substantial-business risk or financial risk. Consequently, they are referred to as high-quality bonds. But since they are high-quality bonds, their prices are determined mainly, by the prevailing level of interest rate in the market. As a result, if interest rates fall, the prices of these bonds will rise, and vice-versa.

Interest rate risk affects all investors in high-quality bonds regardless of whether the investors hold short-term or long-term bonds. Changes in interest rate have the greatest impact on the market position of long-term bonds, Since the longer the period before the bond matures, the greater the effect of the change in interest rates. On the other hand, changes in interest rates will not have much of an impact on-the-market price of short-term bonds, but the interest income on a short-term bonds portfolio may fluctuate markedly from period to period, as interest rate changes. Consequently, changes in interest rates affect investors in long-term as well as short-term bonds.

5. **Social or Regulatory Risk:** The Social or regulatory risk arises where an otherwise profitable investment is impaired as a result of adverse legislation, harsh regulation climate, or in extreme instances nationalization by a socialistic govt. The profits of industrial companies may be reduced by price controls, and rent controls may largely destroy the value of the rental property, hold for income, or as a price-level hedge. The social risk is real political and thus unpredictable, but under a system of representative govt, based on increasing govt, intervention in business affairs, no industry can expect to remain exempt from it.
6. **Other Risk:** Other types of risk, particularly those associated with an investment in foreign securities, are the monetary value risk and the political environment risk. The investor who buys foreign govt, bonds, or securities of foreign corporations often in an attempt to gain a slightly.

### Case Study Answer-

1. **Answer:**

Private placement is method through which the company decided to raise additional capital.

2. **Answer:**

- a. Mobilization of funds is the function being

performed by the financial market in the above case. It performs the allocative function by mobilization of savings and channelizing them into the most productive avenues.

- b. The other three functions being performed by the financial market are outlined below:
  - It helps to determine the price for the financial asset in a particular financial market through the market forces of demand and supply.
  - It provides liquidity to the financial assets by providing ready markets wherein the securities can be easily converted into cash or vice versa.
  - It provides a common platform for exchange of securities thereby reducing the cost of transactions by saving time, effort and money spent by the buyers and sellers in locating each other.

### Assertion Reason Answer-

1. a. Assertion and reason both are correct statements and reason is correct explanation for assertion.
2. b. Assertion and reason both are correct statements but reason is not correct explanation for assertion.





# Marketing | 11

## Meaning of Market:

The term 'market' refers to the place where buyers and sellers gather to enter into transactions involving the exchange of goods and services. The term 'Market' has been derived from the Latin word 'Marcatus' which means 'to trade'.

## Marketing:

Marketing as "a human activity directed at satisfying needs and wants through exchange process". - *Philip Kotler*

Marketing concept holds that a key to achieving organizational goals consists in determining the needs and wants of target markets and delivering the desired satisfactions more efficiently and effectively by competitors.

## Concept of Marketing:



1. **Product Concept:** The core purpose of the product concept is to manufacture cheaper products because the consumers won't pay much price for the products or services. So, the businesses that accompany the product concept manufacture the goods on a mass scale and profit out of the economies of scale.
2. **Production Concept:** It is one of the earliest marketing concepts where the organization concentrates on the ability of its production processes. It is to manufacture the products cheaper to make them ready for the mass population. The center of the production concept is on the quantity, not the quality of the products.
3. **Selling Concept:** As the name suggests, the idea of selling is to sell the company's product through large-scale marketing and promotional activities. It doesn't matter whether they satisfy customers' needs or not.
4. **Marketing Concept:** When it comes to the marketing concept, it is customer oriented. It places customers in the middle of the marketing process, discovering customers' demands and wants, then meeting those needs better than the competitors.



5. **Societal Marketing Concept:** The idea behind the societal marketing concept is based on the welfare of the entire society because it examines the strategy of the marketing concept. What consumers need doesn't mean that it would be useful for them in the long term. What you need and what is suitable for you and society as a whole are two entirely different things.

For example, we all like sweet, spicy, and fast foods. We all desire the same things whenever we go out, but it doesn't imply that it's good for our health and the well-being of the whole society.

**Features of Marketing:**



1. **Needs and Wants:**
  - The marketing process assists consumers in obtaining what they require and desire.
  - A need is said to be known as a state of deprivation or the feeling that one is depriving oneself of something.
  - Needs are fundamental to human beings and are unrelated to a specific product.
2. **Creating a Market Offering:** Market offering refers to a process of offering and introducing a product or service, having given features like size, quality, taste, etc. for the purpose of selling.
3. **Customer Value:** The process of marketing facilitates exchange of products and services between the buyers and the sellers.
4. **Exchange Mechanism:** The process of marketing involves exchange of products and services for money or something.

**Functions of marketing:**





1. **Identify needs of the consumer:** The first steps in marketing function is to identify the needs and wants of the consumer that are present in the market. Companies or businesses must therefore gather information on the customer and perform analysis on the collected information.
2. **Planning:** The next step in marketing function is planning. It is considered very important for a business to have a plan. The management should be very clear about the company objectives and what it wishes to achieve from the created plan.
3. **Product Development:** After the details are received from the consumer research, the product is developed for use by the consumers. There are many factors that are essential for a product to be accepted by the customer, a few factors among the many are product design, durability and cost.
4. **Packing and Labelling:** The first impressions of a product are its packaging and the label attached to it. Therefore, packaging and labelling should be looked after very well. It is a well-known fact that a great packaging and labelling goes a long way in ensuring product success.
5. **Branding:** Branding is referred to as the process of identifying the name of the producer with the product. Certain brands are there in the market which have a lot of goodwill and any product coming from the same brand will be accepted more warmly by the consumers.
6. **Customer Service:** A company has to set-up various kinds of customer service based on their product. It can be pre-sales, technical support, customer support, maintenance services, etc.
7. **Pricing:** It can be regarded as one of the most important parts of marketing function. It is the price of a product that determines whether it will be successful or a failure.

### Marketing and Selling:

1. **Marketing:** It refers to a broad range of activities, of which selling is only one component. Before making a sale, a marketer must plan the type, design, and price of the product, as well as select the distribution channels and the appropriate promotional mix for the target market.
2. **Selling:** It refers to the sale of a product or service through advertising, promotion, and salesmanship. The product's title is transferred from seller to buyer. The primary goal of selling is to turn a product into cash.



### Difference Between Marketing and Selling:

Basis	Marketing	Selling
Scope	It is a broad term that encompasses a variety of activities such as identifying customer needs, product development, pricing, distribution, promotion, and selling.	It is only a part of the marketing process.
Focus	Satisfying the needs and desires of the customers to the greatest extent possible.	Title transfer from seller to consumer
Aim	Profits are generated as a result of customer satisfaction.	Profits are generated by increasing sales volume.
Emphasis	Customer bending based on the product	Creation of products that can meet the needs of the customers.
Strat and end activities	It begins before a product is manufactured.	It begins after a product is created.
Strategies	Product, promotion pricing, and physical distribution are all part of the effort.	Efforts such as promotion and persuasion are required

## Marketing Mix:

The marketing mix is defined by the use of a marketing tool that combines a number of components in order to become harder and solidify a product's brand and to help in selling the product or service. Product based companies have to come up with strategies to sell their products and coming up with a marketing mix is one of them.

## Elements of a Marketing Mix:

1. **Product:** It refers to all decisions relating to the product (branding, packaging, labelling, color).
2. **Price:** Price mix refers to all those decisions which are related to price fixation of product.
3. **Place:** It refers to activities that make firm's products available to the target's customers.
4. **Promotion:** It refers to combination of promotional tools used by the business to inform and get settled customers about the products.

## Classification of Industrial Products:

Products can be classified into two categories:

- Consumers' products,
- Industrial products.

### A. Shopping Efforts Involved:

On the basis of the buyers' time and effort.

1. **Convenience Products:** Convenience goods are consumer products that are frequently purchased for immediate use. Medicines, newspapers, stationery, toothpaste, and so on.
2. **Shopping Products:** Shopping products are those in which buyers spend a significant amount of time comparing the quality, price, style, suitability, and so on at various stores before making a final purchase. For example, electronic goods, automobiles, and so on.
3. **Specialty Products:** Specialty products are goods that have unique characteristics that compel customers to go out of their way to purchase them. For example, art, antiques, and so on.

### B. Durability of Products:

1. **Non-durable Products:** These are consumer goods that are consumed in a short period of time. For example, milk, soap, stationery, and so on.
2. **Durable Products:** Tangible items that can withstand repeated use, such as a refrigerator, radio, bicycle, and so on.
3. **Services:** Intangible services are those activities, benefits, or satisfactions that are sold, such as dry cleaning, watch repairs, hair cutting, postal services, doctor services, and so on.

## Industrial Products:

Industrial products are those that are used as inputs in the manufacturing process.

### Characteristics:

- Number of Buyers
- Channel Levels
- Geographic Concentration
- Derived Demand
- Role of Technical Considerations
- Reciprocal Buying
- Leasing Out

## Classification:

1. **Materials and Parts:** items that are completely incorporated into the manufacturer's products.



2. **Capital Items:** the manufacture of finished goods, such as installations and equipment.
3. **Supplies and Business Services:** short-term goods and services that aid in the development or management of the final product. Repairs and maintenance, for example.
4. **Branding:** Branding is the process of creating a corporate brand identity for consumers and imprinting that brand identity on their minds, which necessitates brand positioning and brand management.  
The process of developing a product's distinct identity. It is the process of identifying a product by using a name, term, symbol, or design alone or in some combination.
5. **Brand:** A name, term, sign, design, or some combination of the above used to identify and differentiate the seller's products from those of competitors.  
Brand name Part of brand which can be spoken, i.e., verbal part of brand. For example, Asian Paints, Uncle Chips etc.
6. **Brand mark:** Part which can be identified but cannot be spoken. For example, Gattu of Asian Paints or the Devil of Onida.
7. **Trademark:** Part which has legal protection so that no other firm can use such name or mark.

### Characteristics of Good Brand Name:

- Short, simple to say, spell, recognize, and remember
- Suggest the product's advantages and characteristics.
- Different from other products
- Adaptable to packing or labelling requirements, as well as different advertising media and languages.
- Versatile enough to accommodate new products.
- Legally registered and protected.

**Packaging:** It refers to the groups of those activities which are related to the designing and production of containers.

### Levels of Packaging:

There are generally three levels of Packaging:

1. **Primary Package:** Primary package is very close to the product. It keeps till the consumer is ready to use and also keeps throughout the entire life of the product.
2. **Secondary Packaging:** Secondary Packaging refers to additional layers of protection that are kept till the product is ready to use.
3. **Transportation Packaging:** Transportation Packaging refers to that packaging which is necessary to use for transportation, identification and storage.

### Importance of Packaging:

- When customers purchased packed products. They feel safe and hygienic because the chances of adulteration in such packed goods are minimized.
- Self service outlets are very popular, particularly in major cities and towns.
- With the help of Packaging many products are kept for several days.
- Packaging creates product differentiation.

### Functions of packaging:

- Packaging helps in identification of product.
- Packaging protects the product from spoilage, breakage, leakage.
- The size and shape of the package should be such that it should be convenient to open, handle and use for the consumers.
- Packaging is also used for promotion purpose.

## Labelling:

Labeling is the process of affixing identification marks to a package. Labels are information carriers that provide information such as the name of the product, the name of the manufacturer, the contents of the product, the expiry and manufacturing date, general information for use, weight, and so on.

## Function of labelling:

- It provides complete information related to the product like weight, price and ingredients of product.
- It makes easier to identify a particular product among many with the help of labelling.
- It helps in grading of the products.
- It helps in promotion of products.
- It provides information related to the products required by law.

## Pricing:

It is considered as the sum of the values that customers exchange in exchange for the benefit of owning or using the product. Price can thus be defined as the sum of money paid by a buyer (or received by a seller) in exchange for the purchase of a product or service.

## Promotion:

- Promotion is the use of communication with the dual goal of informing potential customers about a product or a service as well as persuading them to purchase it.
- Promotion is a critical component of the marketing mix in which marketers use various communication tools to encourage the exchange of goods and services in the market.
- It is a set of promotional tools/techniques used by a company to entice and persuade customers to buy its products.

## Promotion Mix:

A promotion mix is considered as a combination of promotional tools used by a company to achieve its communication goals.

## Promotion mix tools:

- i. Advertising,
- ii. Personal Selling,
- iii. Sales Promotion,
- iv. Publicity.

## Advertising:

Advertising, as defined by a specific sponsor, is a paid form of nonpersonal presentation and promotion of goods, services, or ideas.

## Features:

1. **Paid Form:** The sponsor must bear the cost of communicating with customers.
2. **Lack of Personalization:** There is no direct face-to-face contact between the prospect and the advertiser.
3. **Identified Sponsor:** Advertising is done by a specific person or company.

## Merits:

- **Mass Reach:** a large number of people can be reached across a large geographical area.
- Increasing customer satisfaction and trust.
- **Expressiveness:** It is a powerful medium of communication.
- **Economy:** Because of its wide reach, is a very cost-effective mode of communication.



### Limitations:

- **Less Forceful:** There is no pressure on the prospects to listen to the message.
- **Inflexibility:** It is less flexible because the message is standardized and not tailored to the individual.
- **Low Efficacy:** It is difficult to get advertising messages heard by the intended prospects.

### Objections to Advertising:

Some critics argue that advertising is a social waste because it raises costs, multiplies people's needs, and undermines social values.

1. **Adds to Cost:** Unnecessary advertising raises the cost of the product, which is then passed on to the buyer in the form of high prices.
2. **Undermines Social Values:** It undermines social values while encouraging materialism.
3. **Confuses the Buyers:** A similar product of the same nature/ quality confuses the buyer.
4. **Encourages Sale of Inferior Products:** It makes no distinction between superior and inferior goods.
5. **Some Advertisements are in Bad Taste:** These depict something that some people do not agree with.

### Personal Selling:

Personal selling entails personally contacting prospective buyers of a product, i.e. engaging in a face-to-face interaction between seller as well as the buyer for the purpose of sale.

### Features of the Personal Selling:

1. Under personal selling, personal contact is established.
2. Establishing relationships with prospective customers, which are critical in closing sales.
3. Oral communication.
4. Quick response to queries.

### Merits of Personal Selling:

1. Flexibility
2. Direct Feedback
3. Minimum wastage

### Role of Personal Selling:

#### Importance to Business Organization:

1. Effective Promotional Tool
2. Versatile Tool
3. Reduces Effort Wastage
4. Consumer Attention
5. Long-Term Relationship
6. Personal Relationship
7. Role in the Introduction Stage
8. Customer Relationship

### Sales Promotion:

Short-term incentives or other promotional activities that aim to pique a customer's interest in purchasing a product are referred to as sales promotion.

### Merits of Sales Promotion:

1. **Attention Value:** Using incentives, attract people's attention.
2. **Useful in New Product Launch:** Sales promotion tools persuade people to abandon their usual purchasing habits and try new products.



3. **Synergy in Total Promotional Efforts:** Sales promotion activities contribute to the overall effectiveness of a company's promotional efforts.

### Limitations of Sales Promotion:

1. **Reflects Crisis:** A company that frequently relies on sales promotion activities may give the impression that it is unable to manage its sales and that its products are unpopular.
2. **Damages Product Image:** Customers may believe that the products are of poor quality or are overpriced.
3. **Publicity:** Publicity occurs when favorable news about a product or service is broadcast in the mass media. For example, if a manufacturer makes a breakthrough in the development of a car engine and this news is covered by television, radio, or newspapers as a news item.

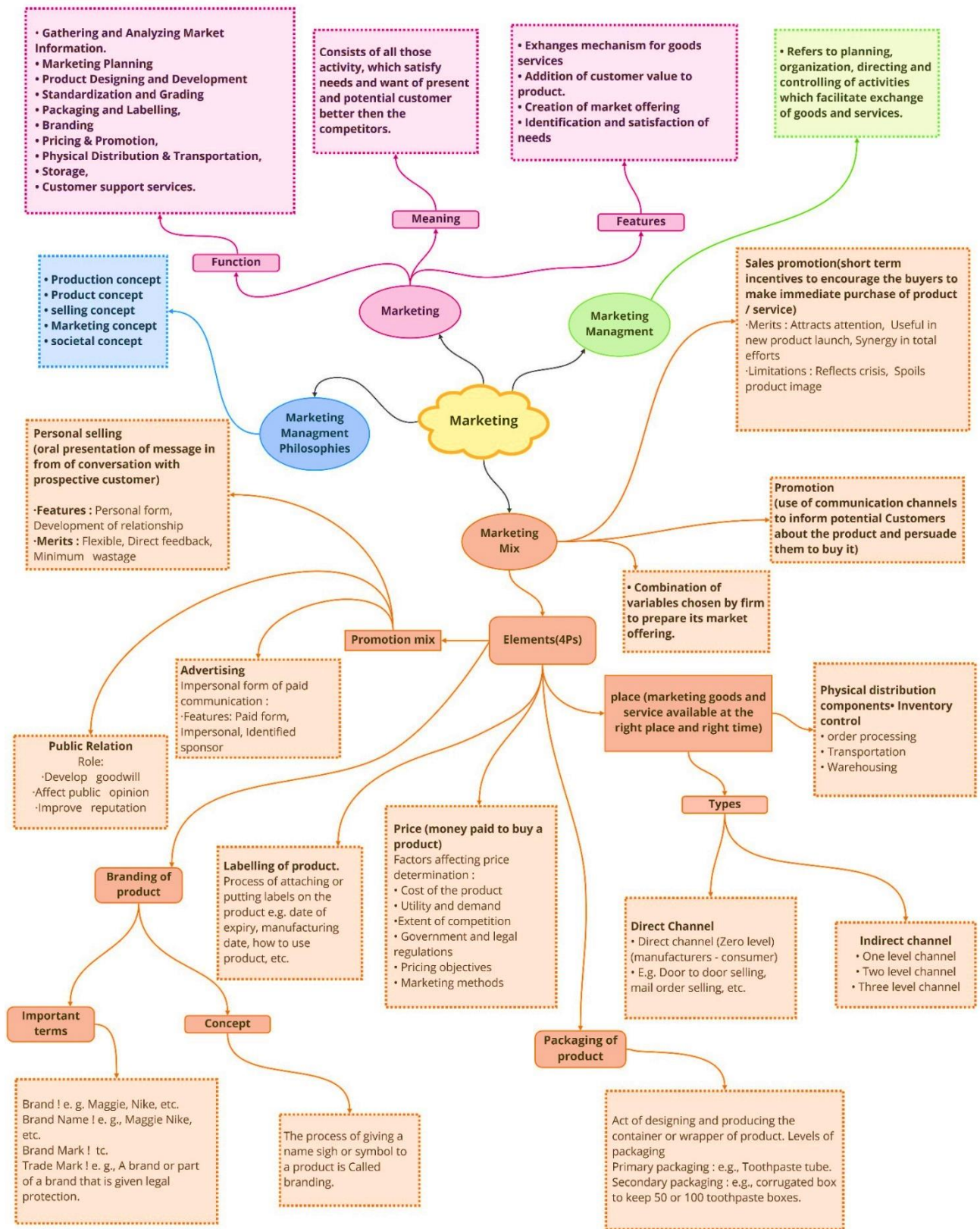
### Features of Publicity are:

1. Publicity is a form of communication that is not compensated.
2. There is no identified sponsor.





Class : 12th Business-studies  
Chapter - 11 : Marketing





## Important Questions

### Multiple Choice questions-

- Scope of \_\_\_\_\_ is limited but scope of \_\_\_\_\_ is wider.
  - Marketing, Selling
  - Selling, Marketing
  - Marketing, Publicity
  - Selling, Manufacturing
- Airtight containers and packets used for chips, biscuits, and jams, etc., are the example of
  - Product differentiation
  - Product identification
  - Product promotion
  - Product Protection
- The Basic role of marketer is to \_\_\_\_\_
  - Sell the product
  - Advertise only
  - Earn more and more profits
  - Identify a need and fill it
- Which of the following is the part of the marketing mix?
  - Price
  - Product
  - Place and Promotion
  - All of the above
- Which of the following is not concerned with the 'Price'?
  - Advertising
  - Discounts
  - List price
  - Margins
- SWOT Analysis is a strong part of \_\_\_\_\_
  - Marketing
  - Selling
  - Publicity
  - None of the above
- Which of the following is a good quality of a good salesperson?
  - Mental quality
  - Honesty
  - Communication skills
  - All of the above
- \_\_\_\_\_ refers to the act of designing and producing the container or wrapper of a product.
  - Trade Mark
  - Brand Name
  - Copyright
  - Packaging
- \_\_\_\_\_ Activities start after the product has been developed.
  - Selling
  - Publicity
  - Marketing
  - None of the above
- Under marketing mix which of the following is not a part of Product?
  - List price
  - Quality
  - Design
  - Brand Name
- Discounts, coupons, contests, free samples and offering extra quantity, etc., are the examples of \_\_\_\_\_
  - Channels of distribution
  - Personal Selling
  - Sales Promotion
  - None of the above
- The word 'Market' has come from the Latin word \_\_\_\_\_
  - Marketo
  - Marketio
  - Marcatus
  - Matico
- Which of the following is a brand name?
  - Nike
  - Woodland
  - Asian Paints
  - All of the above
- Which of the following is a direct channel of distribution?
  - Manufacturer, wholesaler, retailer, customer
  - Manufacturer to customer
  - Manufacturer, retailer, customer
  - None of the above



15. Which of the following is not a part of 'Place and Promotion'?
- Warranties
  - Advertising
  - Personal selling
  - Sales Promotion

### Very Short-

- Give two example of shopping products.
- From producer to retailer to consumer identify the type of channel of distribution.
- Which channel will you recommend for distribution of perishable goods?
- Name any two print medias of advertising.
- Name the concept of marketing which pays attention to the Social, Ethical and ecological aspects of marketing along with consumer satisfaction.
- How does labeling act as a silent Salesman?
- Name the non paid and non personal form of promotional tool.
- "Introducing a scheme of 50% + 40% less by the koutons" is the example of which sales promotion technieue?
- Name the Sales promotion technieue in which 'Scratch Cards' are used?
- 'Automobiles Ltd. Offered to sell their new bike at about Rs. 4000 less than the usual price' is an example of sales promotion. Name the technieue and explain two other Techni with examples.

### Short Question-

- Advertising encourages sale of inferior and dubious products and 'Advertising confuses rather than help's . Do you agree? Give reasons.

OR

'Advertising costs are passed on to the consumers in the form of higher prices" and ' Some advertisements are in bad taste'. Do you agree? Give reasons in support of your answer.

- As a publisher, you have published a new book on marketing management. How will you determine the price of this book?
- You have invented a new device to detect impurities in petrol. Which two advertising media would you use and why?
- Explain the important characteristics of a good brand name?

- Explain the term sales promotion and mention, in brief, the merits and limitations of sales promotion.
- Explain the various objectives of packaging?
- Differentiate between Branding and Trade Marks.
- Explain in brief the importance of promotion mix in marketing?

### Long Questions-

- What is Packaging? Explain the importance and functions of packaging?
- What is the pricing of a product? Explain the important factors affecting the pricing of a product?
- Mention the important features or characteristics of personal selling?
- Explain in detail the various pricing policies of a product?

### Case Study Based Question-

- Ginika, Tanish and Rohit were friends from college days and now they are doing different kinds of business. They regularly meet and discuss their business ideas and exchange notes on customer satisfaction, marketing efforts, product designing, selling techniques, social concerns etc.

In one of such meetings, Ginika drew the attention of Tanish and Rohit towards the exploitation of consumers. She told that most of the sellers were exploiting the consumers in various ways' and were not paying attention towards the social, ethical and ecological aspects of marketing, whereas she was not doing so.

Tanish told that they were under pressure to satisfy the consumers, but stated that the consumers would not buy or not buy enough unless they were adequately convinced and motivated for the same.

Rohit stressed that a company cannot achieve its objectives without understanding the needs of the customers. It was the duty of the businessmen to keep consumer satisfaction in mind because business is run by the resources made available to them by the society. He further stated that he himself was taking into consideration the needs of the customers

Identify the various types of thinking that guided Ginika, Tanish and Rohit in the marketing efforts of their business. Also, state one more feature of the various types of thinking identified that is not given in the above para. (CBSE, Delhi 2017)

2. Mediquip Ltd. is a company dealing in distribution of medical equipments. The company recently imported 15000 units of sugar testing machines to test the sugar levels without taking blood samples. For deciding the marketing strategy, the Chief Executive Officer of the company called a meeting of the marketing heads of different zones.

In the meeting, Sandeep, the North Zone Marketing Head, suggested that since the machines were sophisticated they need to visit hospitals personally, to explain its working to the hospital staff who would be using the machines. He also suggested that additional trained people may be recruited for the same.

Himanshu, another Zonal Head, added that since lot of money had been spent on the import of the machines, the company was short of funds to pay to the additional staff as suggested by Sandeep.

Rahul, a newly appointed Zonal Head of South Zone suggested that since the size of the order is not large, a detailed study of the factors determining the choice of channels of distribution is required before making the right choice.

- Identify the factors influencing the choice of channels of distribution which were discussed in the meeting.
- Also, explain briefly the other consideration to be taken care of in each factor identified in part (1).

### Assertion Reason Question-

1. In these questions, a statement of assertion followed by a statement of reason is given.

Choose the correct answer out of the following choices.

- Assertion and reason both are correct statements and reason is correct explanation for assertion.
- Assertion and reason both are correct statements but reason is not correct explanation for assertion.
- Assertion is correct statement but reason is wrong statement.
- Assertion is wrong statement but reason is correct statement.

**Assertion (A):** The job of the marketer is to add to the value of the product so that customer prefers it in relation to the competing products and decides to purchase it.

**Reason (R):** A product will be purchased only if it is perceived to be giving the greatest benefit for the money.

2. In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.

- Assertion and reason both are correct statements and reason is correct explanation for assertion.
- Assertion and reason both are correct statements but reason is not correct explanation for assertion.
- Assertion is correct statement but reason is wrong statement.
- Assertion is wrong statement but reason is correct statement.

**Assertion (A):** According to Marketing Concepts, products are bought because of their quality and other features.

**Reason (R):** The marketing concept aims to find out the needs and requirements of customers and satisfying them in an effective manner.

## Answer Key

### MCQ Answers-

- Answer:** (b) Selling, Marketing
- Answer:** (d) Product Protection
- Answer:** (d) Identify a need and fill it

- Answer:** (d) All of the above
- Answer:** (a) Advertising
- Answer:** (a) Marketing
- Answer:** (d) All of the above



8. **Answer:** (d) Packaging
9. **Answer:** (a) Selling
10. **Answer:** (a) List price
11. **Answer:** (c) Sales Promotion
12. **Answer:** (c) Mercatus
13. **Answer:** (d) All of the above
14. **Answer:** (b) Manufacturer to customer
15. **Answer:** (a) Warranties

### Very Short Answers-

1. **Ans.** a) Clothes  
b) Shoes
2. **Ans.** One Level channel.
3. **Ans.** zero Level or One Level Channel.
4. **Ans.** Magazines, Newspapers.
5. **Ans.** Societal concept of marketing
6. **Ans.** Labeling act as a silent salesman because it helps in promotion of products by attracting the attention of customers and providing required information.
7. **Ans.** Publicity.
8. **Ans.** The name of this sales promotion scheme is 'Discount'.
9. **Ans.** It is "Instant draw and assigned gift".
10. **Ans.** Hints: The name of this technique is 'Rebate'. Under it, in order to clear the excess stock products are offered at reduced prices. Explain two other Techni such as full finance @0% and samples.

### Short Answer-

1. **Ans.** no, explain the arguments in favor and against of advertising. Conclusion: in the era of globalization advertising is considered as an important tool of marketing.it helps in increasing sales and thereby reducing cost.it is not a social waste rather boosts production and employment.
2. **Ans.** Hint- For following factors are to be discussed before fixing price of the book.
  - a) cost of Production.
  - b) Demand of the book.
  - c) Price of other competitive books.
  - d) Purchasing power of the customer.
  - e) Gout regulation etc.
3. **Ans.** Two methods of advertising that I would adopt are

- 1) Newspaper and television
- 2) Direct selling at the point of purchase of petrol *i.e.* at petrol pump.

Reasons for opting for direct selling at petrol pumps are –

- 1) this method is suitable for introducing new product.
- 2) It will reach directly to the targeted consumer group.
- 3) The working of the new device can be demonstrated to the consumers at the site itself.

4. **Ans.** Characteristics of Good Brand Name: Choosing the right brand name is not an easy decision what makes this decision important is the fact that once a brand name is chosen and the product is launched in the market. Changing the brand name is very difficult. So getting it right the first time is very essential following are some of the considerations which should be kept in mind while choosing a brand name.

1. The brand name should be short easy to Pronounce, spell, recognized, and remember e.g. ponds, VIP, Rin, Vim Etc.
2. A brand should suggest the product's benefits and qualities. It should be appropriate to the product's functions, e.g. Rasika, Genteel, Promise, My fair Lady, and Boost.
3. A brand name should be distinctive e.g. Liril, sprit, Safari, Zodiac;
4. The brand name should be adaptable to packaging or Labelling requirements to different advertising media and to different languages.
5. The brand name should be sufficiently versatile to accommodate new products, which are added to the product line e.g. Maggie, Colgate;
6. It should be capable of being registered and protected legally; and
7. The chosen name should have to stay power ie; it should not get out of data.

5. **Ans.** Sales Promotion refers to short-term incentives which are designed to encourage the buyers to make immediate purchase of a product or service these include all promotion effort

other than advertising, personal selling, and publicity, used by a company to boost its sale sales promotion activities include offering a cash discount, sales contests, tress gift offers and free sample distribution, sales promotion include only those activities that are used to provide short term. incentives to boost the sales of a firm.

#### Merits of Sales promotion:

1. **Attention Value** Sales promotion activities attract the attention of the people because of the use of incentives.
2. **Useful in New Product Launch** Sales Promotion tools can be very effective at the time of introduction of a new product in the market. It includes people to break away from their regular buying behavior and try the new product.
3. **Synergy in total promotional efforts** Sales Promotion activities is designed to Supplement the personal selling and advertising efforts used by a firm and add to the overall effectiveness of the promotion efforts of a firm.

#### Limitation of Sales promotion:

1. **Reflects Crisis** It a firm frequently rely on Sales promotion, it may give the impression that it is unable to manage its sales or that there are no takers of its product.
2. **Spills Product Image** Use of Promotion tools may affect the image of a product. The buyers may start feeling that the product is not of good quality or is not appropriately priced.

#### 6. Ans. Objectives of Packaging:

1. **Attraction:** As far as possible, the package must possess attraction value, as attraction is the main objective of packaging, so that it may attract customers towards the products concerned.
2. **Protection:** The second objective of packaging is to provide safety to the product. In other words, the package must protect the contents of the product until it is consumed. The package keeps the product fresh and clean. It protects from adverse effects of weather, temperature, dampness, insects, contamination, breakage, evaporation, leakage, etc. It preserves the flavor and color of the product. It also prevents theft and pilferage.

3. **Convenience:** The consumers, as well as the middlemen, want packages that are easy to carry, use and dispose of. A good package facilitates easy transportation; storage, display, and usage. Pouch packing is very popular nowadays due to convenience.

4. **Economy** The next important objective of packaging is economy. Here economy means economic use of the product. The consumer can take out the only quantity to be used at a time and thus, wastage can be avoided.

5. **Sales Promotion** The objective of packaging is to promote the sale of the product. Whatever is written on the packing acts as an advertisement and sales promotion.

6. Other objectives of packaging are as under,
1. It improves the image of the product and thus increases the profit.
  2. It maintains the utility of the package even after the product packed is consumed.
  3. Owing to data of manufacturing and the expiry printed on the packing, the freshness or expiry of products can be identified.

7. **Ans. Difference between Brand and Trade Mark:** Difference between brand and trademark can be made on the basis of the following points

1. **Registration:** Registration of a brand is not essential while registration for a trademark is essential. A brand is called a trademark only when it is registered.
2. **Scope:** The scope of a brand is limited while the scope of a trademark is very wide. Any business firm can use different brands for its different products while it uses only one trademark for all of them.
3. **Legal protection:** Brand can be copied by other competing concerns. No legal actions can be taken against them but if trademark denotes the manufacturer who got it registered. So trademark can be used with every brand. ‘
4. **Nature:** All brands are not trading marks but all trademarks are the brands. Thus, the word brand is more comprehensive than the trademark.



5. **Use:** Brand can be used by all that but the trademark can be used by the business firm that got it registered in the name of the firm. In simple words, the main difference between brand and trademark is that brand is not registered, whereas trademark is always registered under Trade and Merchandise Mark Act, 1958.

8. **Ans.** Importance of Promotion in Marketing: Promotion plays an important role in stimulating demand and sales of the product. Its importance may be gathered from the following facts

1. In depression, the importance of promotional activities is greater because, at such a time, the main problem is that of sales of goods and services.
2. The activity of promotion has become important because of the widening of the market. With the physical distance between producers and consumers and also the increase in the number of prospective buyers, the promotion has gained importance. The producer is now to inform all prospective consumers to capture a major share of the market.
3. There are a number of channels of distribution. The producer should not only inform the consumers but he should also inform about the product to the middlemen because they have to present the goods to the middlemen next in the hierarchy and to the consumers. The middlemen should be well versed in the characteristics of the goods.
4. In modern times, there is cut-throat competition in every field. New and new products and producers are entering the market and every producer wants to sell his products first. In order to meet the competition, the producer is to make the customers/prospective customers of his products and their outstanding features along with a comparative view of the competitor's products. This helps the consumers to select the right type of product.
5. Promotion expenses are the highest of all

the marketing expenses. They should be properly and strictly controlled and should be paid due attention.

### Long Answers-

1. **Answer:** Packaging: One of the most important developments affecting the business world in recent years has been in the area of packaging. Many products, which we thought could never lend themselves to packing because of their nature, have been successfully packed e.g. pulses, ghee, milk, salt, cold drinks, etc. Packaging refers to the act of designing and producing the container or wrapper of a product, packaging plays a very important role in the marketing success or failure of many products, particularly the consumer non-durable products.

In fact, if one makes an analysis of the reasons for the success of some of the successful products in the recent past, it can be noted the packaging has played its due role. For example, it was one of the important factors is the success of products like Maggie Noodles, Uncle Chips, or Crax Wafers.

Importance of Packaging: Packaging has acquired great significance in the marketing of goods and services, because for the following reasons

1. **Rising standards of Health and Sanitation:** Because of the increasing standards of living in the country, more and more people have started purchasing packed goods as the chances of adulteration as such goods are minimized.
2. **Self-Service Outlets:** The self-service retail outlets are becoming very popular, particularly in major cities and towns. Because of this, some of the traditional roles assigned to personal selling in respect be promotion have gone to packaging.
3. **Innovational Opportunity:** Some of the recent development in the area of packaging have completely changed the marketing scene in the country. For example, milk can now be stored for 4-5 days without refrigeration in the recently developed packing materials. Similarly, in the area of pharmaceuticals, soft drinks, etc, lots of new innovations have come in respect of packaging. As a result, the scope for the marketing of such products has increased.

4. **Product Differentiation:** Packaging is one of the very important means of creating product differentiation. The color, size, materials, etc. of the package makes a real difference in the perception of customers about the quality of the product. For example, by looking at the package of a product say paint or hair oil one can make some guess about the quality of the product contained in it.

#### Functions of Packaging:

As stated above, packaging performs a no. of functions in the marketing of goods. Some of the important functions are as follows:

1. **Product Identification:** Packaging greatly helps in the identification of the products. For example, Colgate in red color, or Ponds Cream jar can be easily identified by its package.
  2. **Product Protection:** Packaging protects the contents of a product from spoilage, breakage, leakage, pilferage, damage, climatic effect, etc. This kind of protection is required during storing, distribution, and transportation of the product.
  3. **Facilitating the use of the Product:** The size and shape of the package should be such that it should be convenient to open, handle and use for the consumers. Cosmetics, medicines, and tubes of toothpaste are good examples of this.
  4. **Product Promotion:** Packaging is also used for promotion purposes. A startling color scheme, photograph, or typeface may be used to attract the attention of the people at the point of purchase. Sometimes it may work even better than advertising. In self-service stores, this role of packaging becomes all the more important.
2. **Answer: Pricing:** When a product is bought, some money is paid for it. This money represents the sum of values that consumers exchange for the benefit of having or using the product and is referred to as the price of the product. Similarly, money paid for the services such as fare for the transport service, premium for an insurance policy, and fee to a doctor for his medical advice represent the price of these services. Price may therefore be defined as the amount of money paid

by a buyer (or received by a seller) in consideration of the purchase of a product or a service.

**Factors affecting Price Determination:** There is a number of factors that affect the fixation of the price of a product. Some of the important factors in this regard are discussed below:

1. **Product Cost:** One of the most important factors affecting the price of a product or service is cost. This includes the cost of producing, distributing, and selling the product. The cost sets the minimum level or the floor price at which the product may be sold. Generally, all marketing firms strive to cover all their costs, at least in the long run. In addition, they aim at earning a margin of profit over and above the costs.

In certain, circumstances, for example, at the time of introducing a new product or while, entering a new market, the product may be sold at a price, which does not cover all the costs. But in the long run, a firm cannot survive unless at least all its costs are covered.

There, are broadly three types of costs: viz fixed costs, variable costs, and semi-variable costs. Fixed costs are those costs, which do not vary with the level of activity of a firm says the volume of production. or sale. For example, the rent of a building or the salary of a sales manager remains the same whether 1000 units or 10 units are produced in a week.

Those costs which vary in direct proportion with the level of activity are called variable costs, for example, the cost of raw materials, labor, and power is directly related to the quantity of I goods produced. Let us say if the cost of wood for manufacturing one chair comes to Rs. 100/- the cost of wood, for 10 chairs would be Rs 1000/- obviously, there will be no cost of wood if no chair is produced.

Semi variable costs are those costs that vary with the level of activity but not in direct proportion with it change in the volume of sale.

Total costs are the sum total of the fixed variable and semi-variable costs for the



specific level of activity say the volume of sales or quantity produced.

2. **The Utility and Demand:** While the product costs set the lower limits of the price, the utility provided by the product and the intensity of demand of the buyers sets the upper limit of price, which a buyer would be prepared to pay. In fact, the price must reflect the interest of both the parties to the transaction the buyers and the seller. The buyers may be ready to pay up to the point where the utility from the product is at least equal to the sacrifice made in terms of the price paid. The seller would, however, try to at least cover the costs. According to the law of demand, consumers usually purchase more units at a low price than at a high price.

The price of a product is affected by the elasticity of demand of the product. The demand is said to be elastic if a relatively small change in price results in large changes in the quantity demanded. Here numerically the price elasticity is greater than one. In the case of inelastic demand, the total revenue increases when the price is increased and goes down when the price is reduced. If the demand for a product is inelastic, the firm is in a better position to fix higher prices.

3. **Extent of Competition in the market:** Between the lower limit and the upper limit where would the price settle down. This is affected by nature and the degree of competition. The price will tend to reach the upper limit in case there is a lesser degree of competition while under conditions of free competitors the price will tend to be set at the lowest level.

Competitor's prices and their anticipated reactions must be considered before fixing the price of a product. Not only the price but the quality and the features of the competitive products must be examined carefully, before fixing the price.

4. **Government and Legal Regulations:** In order to protect the interest of the public against unfair practices in the field of price-fixing, the government can intervene and

regulate the price of commodities. The government can declare a product as an essential product and regulate its prices. For example, the cost of a drug manufactured by a company having a monopoly in the production of the same was Rs. 20/- per strip of ten and the buyer is prepared to pay any amount for it say Rs. 200/-.

In the absence of any competitor, the seller may be tempted to export the maximum amt. of Rs. 200/- for the drug and intervene to regulate the price. Usually, in such a case, the govt does not allow the first to charge such a high price and intervene to regulate the price of the drug. This can be done by the govt, by declaring the drug as an essential commodity and regulating its prices.

5. **Pricing objectives:** Pricing objectives are another imp. factor affecting the fixation of the price of a product or a service. Generally, the objective is stated to be to maximize the profits. But there is a difference in maximizing profits in the short run and in the long run. If the firm decides to maximize profits in the short run, it would tend to charge maximum price and its products. But if it is to maximize its total profit in the long run, it would opt for a lower per-unit price so that it can capture a larger share of the market and earn greater profits through increased sales.

Apart from profit maximization, the pricing objectives of a firm may include:

- (a) **Obtaining market share leadership:** If a firm objective is to obtain a larger share of the market, it will keep the price of its products at lower levels so that a greater no. of people are attracted to purchase the products.
- (b) **Surviving in a competitive market:** If a firm is facing difficulties in surviving in the market? because of intense competition or the introduction of a more efficient substitute by a competitor, it may resort to discounting its products or running a promotion campaign to liquidate its shock, and



(c) **Attaining product quantity leadership:** In this case, normally higher prices are charged to cover high quality and high cost of Research and Development.

Thus, the price of firm products and services is affected by the pricing objective of the firm.

6. **Marketing Method Used:** The price fixation process is also affected by other elements of marketing such as distribution system quality of salesman employed, quality and amount of advertising, sales promotion efforts the type of packaging product differentiation, credit facility, and customer service provided. For example, if a company provides free home delivery, it has some flexibility in fixing prices. Similarly, the uniqueness of any of the elements mentioned above gives the company competitive freedom in fixing the prices of its products.
3. **Answer:** Characteristics of Personal selling: Following are some imp. characteristics of personal selling
1. Personal selling is a method of sales communication.
  2. Personal selling includes commercial and social behavior.
  3. Personal selling includes both selling functions and non-selling functions.
  4. It involves the persuasion of customers.
  5. It involves winning buyers' confidence.
  6. It aims at providing information and services to buyers.
  7. It is a two-way process and benefits both buyers and sellers.
  8. It helps in solving the problems of the buyers and satisfying their needs.
  9. Personal selling is an educative process. It tells consumers the way in which they can satisfy their needs.
  10. Personal selling is more flexible and adaptable. Because of face communication, the salesman adjusts himself and his sales talks according to the need, desires, and behavior of the consumers.

**Role of Personal Selling:** Personal selling plays a very important role in the marketing of goods and services. The importance of personal selling to businessman, customers, and society may be described as below:

**Importance to Businessmen:** Personal selling is a powerful tool for creating demand for a firm's products and increasing their sales. The importance of personal selling to a business organization may be described as follows:

1. **Effective Promotional tool:** Personal selling is a very effective promotional tool that helps in influencing the prospects about the merits of a product and thereby increasing its sales.
2. **Flexible tool:** Personal selling is more flexible than other tools of promotion such as advertising and sales promotion. It helps business persons in adopting their offer in varying purchase situations.
3. **Minimise wastage of efforts:** Compared with other tools of promotion, the possibility of wastage of efforts in personal selling is minimum. This helps the business persons in bringing economy in their efforts.
4. **Consumer attention:** There is an opportunity to detect the loss of consumer attention and interest in a personal selling situation. This helps a business person, in successfully completing the sale.
5. **Lasting relationship:** Personal selling helps to develop a lasting relationship between the salespersons and the customers, which is very important for achieving the objectives of a business.
6. **Personal rapport:** The development of personal rapport with customers increases the 'competitive strength' of a business organization.
7. **Role in the introduction stage:** Personal selling plays a very important role in the introduction stage (of a new product) as it helps in persuading customers about the merits of the product.
8. **Link with customers:** Salespeople play their different roles, namely persuasive role, service role, and informative role, and thereby link a business firm to its



customer's importance to Customers

This role of personal selling becomes more imp. for the illiterates and rural customers who do not have many other means of getting product information.

The customers are benefited from personal selling in the following ways

1. **Help in identifying needs:** Personal selling helps the customers in identifying their needs and wants and in knowing how these can best be satisfied.
2. **Latest market information:** Customers get the latest market information regarding price changes product availability and shortage and new product introduction which helps them in taking the purchase decisions in a better way.
3. **Expert advice:** Customers get expert advice and guidance in purchasing various goods and services which help them in making a better purchase.
4. **induces Customers:** Personal selling induces customers to purchase new products that satisfy their needs in a better way and thereby helps to improve their standards of living.

**Importance of society:** Personal selling plays a very productive role in the economic progress of a society. The more specific benefits of personal selling to society are as follows:

1. **Converts latent demand:** Personal selling converts latent demand into effective demand. It is through this cycle that the economic activity in the society is fostered, leading to more jobs, more incomes, and more products and services. That is how economic growth is influenced by personal selling.
2. **Employment opportunities:** Personal selling offers greater income and employment opportunities to unemployed youth.
3. **Career opportunities:** Personal selling provides an attractive career with greater opportunities for advancement and job satisfaction as well as security, respect, variety, interest, and independence to young men and women.

4. **Mobility of Salespeople:** There is a greater degree of mobility in salespeople, which promote travels and tourism in the country.
5. **Product standardization:** Personal selling increases product standardization and uniformity in consumption patterns in a diverse society.

4. **Answer:** Pricing Policies Policies are guidelines for achieving the objectives. Therefore, different policies are framed and adopted for achieving the different objectives. Thus price policy is framed and adopted 'policies provide the framework and consistency needed by the company to make reasonable, practicable, and effective pricing decisions. It helps the company to attain its pricing objectives.

Any good pricing policy must be aimed at offering a reasonable price to the consumer, ensuring a fair return on investment, and provide, price stability. While adopting the price policy trade traditions, customer preferences, their buying motives, purchase frequency, level of competition, nature of the product, amount of discount and allowances to be given, etc. must be considered.-There are a number of pricing Policies, a brief explanation of them is as follows:

- A. On the basis of Cost and Demand. There are two price policies
  1. **Cost-oriented pricing policy:** This policy assures that no product is sold at a loss since the I price covers the full, coat incurred. Pricing under this policy is based on simple arithmetic i.e.; adding a fixed percentage to the Unit Cost.
  2. **Demand-oriented pricing policy:** Under the policy of a product is based upon its demand in the market. For instance, a high price is charged when and where the demand is high and a low price is charged when and where the demand is low. This policy is more suited to small business units and mostly in the case of non-standardized products.
- B. On the basis of Price-Level. There are three price policies:

**Meeting Competition Policy:** If the price is the main basis of competition, then

companies adopt this policy and adjust their prices according to that of competitors. If the competitors change their price, the company will do the same. Such a policy is adopted in the case of highly competitive goods. One important feature of the policy is that it may not have any relationship to its cost and demand of the

**Under the Market policy:** It is a policy in which a company keeps its prices less than those prevailing in the market. Under the market, the policy is adopted when a company wants to enter the market or wants to expand it. Sometimes, a company has low costs because its products are of lower quality and therefore, the price of products is usually kept low than those of competitors. At other times, lower prices may be substituted for promotional efforts used by its competitors.

**Above the Market policy:** Under this policy, the company keeps its prices more than those prevailing in the market. This policy is adopted by companies who either enjoy a good reputation in the market or offer a unique product. The customers get attracted to the company because of its high prestige. Such a company spends highly on advertising. Sometimes, manufacturers keep more than above price to give some more margin to profit to a middleman in return for their aggressive marketing efforts.

- C. On the basis of Flexibility. There are two pricing policies:
1. **One price Policy:** Under this policy, one price is charged from all types of customers irrespective of volume or conditions of purchase. Price is fixed in this policy. It is a fair trade practice. Such a policy helps in clearly estimating the sales and profits. This policy helps in bargaining as it saves time and selling expenses. These companies, who follow this policy, lay emphasis on the product's quality and customer service.
  2. **Flexible pricing policy:** Under this policy, different buyers are charged

different prices for the same product. The difference in price depends upon the bargaining power of buyer and seller, place of delivery, market conditions, and many other such factors. It is generally adopted in the case of sub-standard products. This policy makes the seller free to adjust the price according to the prevailing market circumstances. In certain cases, the product may be prepared on the basis of specification or design given by the buyer. In such a case, the price has to be negotiated and then fixed.

- D. On the basis of Geographical Conditions. There are six pricing policies:

1. **Uniform delivery pricing policy** is also known as 'F.O.R.' (Free on the rail) or 'Destination price' or 'Postage stamp' pricing policy. Under this same price is charged from all the buyers irrespective of their location. In other words, the buyers do not bear directly the freight and other charges because the price includes such charges. They actually add in full or average of total freight charges for all the nation to the price quoted. Such a pricing system is used where transport costs are a major change on the seller's total cost structure as a case of medicines.
2. **Production point pricing policy** It is that type of pricing policy in which the firm quotes 'Ex-factory' or 'Free on rail' price. It does not bear the transportation cost, in the case of ex-factory price, the buyer bears all the transportation costs both freight and cartage from the factory point, whereas in the case of F.O.R. price, the firm bears the freight charges up to the railway station as the transport agency. After that, the buyer has to meet, freight and cartage. It is also called as 'Free on, Board' (F.O.B) pricing policy. In simple words, under this policy, the price of the product includes only the price of the product. All the expenses of transportation from the price of the



- product. All the expenses of transportation from the place of the seller to the place of buyers are paid by the buyer himself.
3. **Zonal delivery pricing policy** Under this policy, the company divides the country into different zones and quotes uniform prices for each zone. The prices are uniform within a zone. But these prices differ from zone to zone, because of differences in transportation costs, local taxes, etc. The company adds average transportation cost to the basic price to arrive at the zonal price. Such a price benefits the buyer living at a distant place within a zone.
  4. **Basepoint pricing policy:** It implies partial absorption of the transport cost by the company. One or more geographical locations are selected as base points from which the transport costs are, calculated. The buyers pay the ex-factory price plus freight calculated from the nearest base point. This price policy is normally the collective decision of all the firms.
  5. **Freight absorption pricing policy:** To penetrate distant market a seller may be willing to absorb part of the freight cost. Thus, under the freight absorption policy, the price of a product includes its actual price and a part of transportation cost. Therefore, the total expenses to be incurred on transportation of goods are divided into two parts – a part of these expenses is paid by the seller and the remaining part is paid by the buyer. A freight absorption strategy is adopted to offset the competitive disadvantages of F.O.B. or ex-factory pricing.
  6. **Home delivery pricing policy** This policy is gaining popularity in cities. Under this policy, dealers quote the price of a product and delivered the goods at the door-step of the customer. Dealers of television, fridge, air-condition, washing machines, steel furniture, and Haryana merchants usually adopt a home delivery pricing policy.
- E. On the basis of Speciality: On the basis of the specialty of the product, market conditions, trade -conditions, different sellers use the following pricing policies:
1. **Skimming pricing policy:** It involves setting a very high, price for a new product initially and to reduced the price gradually as competitors enter the market. The initial high price serves to skim the cream of the market. This is a policy of recovering the product<sup>^</sup> generally adopted in the case of an innovative product.
  2. **Penetration pricing policy:** This policy aims at capturing the market as soon as possible, therefore, the prices are kept at a low level. It helps in the initial stage or till the product is accepted by the majority of the population.
  3. **Price lining policy:** Under this policy, various products are v priced according to their quality standards. The products may be classified as good, better and best – Different prices are charged for different qualities. The price lining has attraction both for the consumers and the retailers. The consumer's buying decisions are simplified since the no. of prices from which he must make a selection is limited. The retailers also find this policy attractive because it helps them to plan their buying decisions.
  4. **Full-line pricing policy:** When a manufacturer produces a product in different sizes or models and is unable to calculate the fixed expenses incurred on each type of product separately, he priced his product according to sizes or their demand.
  5. **Unit pricing policy:** Under this policy price of the package and price per unit are mentioned on the package. For example, a toothpaste of 100 grams bears the price of a 100 grams package

- and also the price of 1 gm. This policy facilitates the consumers to make their buying decision and there is no scope of any bargaining.
6. Bait pricing policy to kinds of products are manufactured under this policy i.e. low price products. The marketer attracts the consumer by showing low price products. Thus, low prices act as bait for attracting customers.
  7. **Psychological Pricing policy:** Under this policy prices are forced in such a manner that they have some psychological effect on buyers. Certain consumers have a feeling that high priced products are indicated of high quality. As such, they demand high priced products. For example, diamonds, electronic products, cosmetics, etc. The pricing of products according to their quality standards as superior, fine, or economical also puts psychological pressure on consumers.
  8. **Old Pricing policy:** It is another form of psychological pricing policy. Under this policy price is ending in an odd no. or a price just under a round number i.e. setting the price at an off amount such as Rs. 199.95 instead of Rs. 200 or Rs.5.990 instead of 6,000. The rationale for this policy is that consumers perceive off prices as a better buy. Even extensive products appear less expensive when the period in this way. This policy gives the feeling that the company is true to the last paisa, and results in an increase in sales.
  9. **Customary pricing:** The policy is one that is based on the customs prevailing in the market. The prices are fixed to suit local conditions. Such products are typically standard ones. The price of sweets, soft drinks, bread, and other eatables are based on customary pricing policy.
  10. **Prestige pricing policy:** Generally, the prestige pricing policy is adopted in the case of luxury products where the salesman is successful in creating a prestige of his product in the consumer's mind. In this case, prices so fixed are generally higher than the prevailing market price. Sometimes, to show that our product is a quality product, market fix higher price for his product in comparison to competitors. Because customers judge the quality of a product by its price. If the price is high, they assume that quality is good. This policy is only useful when actually the quality of the product is genuine and high.
  11. **Captive pricing policy:** In a captive pricing policy, the basic product is priced low, often below cost, but the high markup on supplies required to operate the basic product compensates for that low price. The loss on the basic product is recovered in profits from the sale of the required supplies. This policy is adopted by the newspaper. A newspaper costs, more to produce and distribute than the price charged from the subscribers, but increased circulation encouraged by the low price leads to more advertising revenue and greater overall profit.
  12. **Loss leader pricing policy** Under this policy, few popular products are temporarily offered at low prices with a view to attracting customers. Such products are termed as loss leaders.
  13. **Leader pricing policy** The business firm who wants to present itself pioneer in the industry take the initiative in fixing the price and other firms follow it. This is generally adopted in oligopolistic market conditions where there are few sellers and these products are identical.
  14. **Monopoly pricing policy:** Monopoly pricing policy is adopted when one company has single-handed control over the entire supply, there are a large number of buyers but only one seller. The product is unique with no close substitutes. The competition is totally absent and the seller has a free hand



- in fixing the price. Monopoly prices are generally considered as high prices.
15. **Discriminating pricing policy:** Under this policy, the marketer sells the same product at different prices to different buyers. This discrimination may be on basis of the use of product type of customer, the difference in a geographical area, etc.
  16. **Dual pricing policy** Under dual pricing policy, a producer is required to sell a part of his production, under compulsion, to the govt, or its authorized agency at a substantially low price.
  17. **Administrated pricing policy** Prices fixed by the govt, of goods sold through fair price shops are administered prices. This policy favors the welfare of low-income group people.
  18. **Sealed bid pricing policy** Big firms or the govt, calls for competitive bids when they want to purchase certain products or specialized terms. The lowest bidder gets the work.
  19. **Break-even pricing policy** The level of output of which the total revenue will be equal to the total cost is known as the break-even point. Sales over this point will yield profit. The sale must be above the break-even point quantity.
  20. **Promotion pricing policy** This policy is based on its sales promotion method. For instance, take the case of 'Grand Reduction Sale' which is intended to revive the memory of the customs who might have stopped buying the products they used to buy in past. In this case, the seller tries to get rid of old and outdated stock.

### Case Study Answer-

#### 1. Answer:

The various types of thinking that guided Ginika, Tanish and Rohit in the marketing efforts of their business are described below:

- **(Ginika) Societal marketing concept:** The main focus of this philosophy is on both the needs of the potential buyers as well as

concern for the society at large. The ends include profit maximisation through customer satisfaction and social welfare.

- **(Tanish) Selling concept:** The main focus of this philosophy is on existing products. The ends include profit maximisation through sales volume.
- **(Rohit) Marketing concept:** The main focus of this philosophy is on customers needs. The ends include profit maximisation through customer's satisfaction.

#### 2. Answer:

a. The factors influencing the choice of channels of distribution which were discussed in the meeting are listed below:

- **Product related factors:** It has been mentioned that the machines were sophisticated.
- **Market related factors:** It has been mentioned that the size of the order is not large. (in)
- **Company related factors:** It has been mentioned that the company was short of funds to pay the additional staff which had to be recruited to personally visit and train the hospital staff.

b. The other considerations to be taken care of in each of these factors is explained below:

#### The market related factors:

- **Geographical concentration of potential buyers:** If the potential buyers for the firm's product are geographically concentrated at a few specific places, it is advisable for the marketer to adopt direct channels of distribution. If the market for the product is widely scattered, indirect channels of distribution will be more effective.
- **Size of market:** If the size of the target market is small, it is advisable that the marketer adopts methods of direct channels of distribution like online selling, mail order house, personal selling etc. wherein there are no intermediaries between the manufacturer and the consumers. However, if the marketer intends to

target larger markets he should adopt indirect channels of distribution (one level, two level or three level) by using intermediaries like wholesalers, retailers etc.

S.No	Type of channel	Size of market	Geographical concentration of potential buyers
1	Direct	Small	Concentrated
2	Indirect	Large	Widely Scared

**Product related factors:**

- Nature of product:** Considering the technical nature of the industrial products they require short channels i.e., direct channel or involving few middlemen. Moreover, they are made to order and expensive products purchased by selective buyers. Whereas the consumer products, being standardised, less expensive, less bulky, non-technical can be better distributed by long network of channels, involving many middlemen. Moreover they are purchased frequently.
- Type of product:** If the product under consideration is perishable like fruits, vegetables, and dairy products short channels should be adopted in order to preserve their quality. Whereas non-perishable products like toiletry products (e.g., shampoo, toothbrush, deodorants etc.), groceries (cooking oil, pulses etc.), fabrics can be best marketed through longer channels so as to reach wide spread consumers.
- Unit value of the product:** If the unit value of a product is low as in case of most

convenience products, long channels are considered more appropriate whereas products of high value should be sold through shorter channels.

S.No	Type of channel	Nature of Product	Type of product	Unit Value of the Product
1	Direct	Perishable	Industrial	More
2	Indirect	Non perishable	Consumer	Less

**Company related factors:**

**The degree of control it wants to hold on other channel members:** Short channels may be used if the management of the firm desires to have greater control on the channel members, but if the management does not plan to exercise strict control over the middlemen indirect channels or large number of intermediaries may be opted for.

S.No	Type of channel	The degree of control it wants to hold on other channel members
1	Direct	Concentrated
2	Indirect	Widely Scared

**Assertion Reason Answer-**

- a. Assertion and reason both are correct statements and reason is correct explanation for assertion.
- d. Assertion is wrong statement but reason is correct statement.





# Consumer Protection

# 12

## Consumer:

Any individual who purchases products or services for his personal use and not for manufacturing or resale is called a consumer. A consumer is one who is the decision-maker whether or not to buy an item at the store or someone who is influenced by advertisement and marketing.

## Consumer protection:

Modern marketing begins with the customer & ends with the customer. A consumer is said to be king in a free-market economy so customer needs protection from any malpractices.



## Importance of Consumer Protection:

### A. From Consumer's Point of View:

1. **Consumer Ignorance:** The majority of consumers are unaware of their rights and remedies, and as a result, they are constantly exploited. Consumer protection is required to protect consumers from such exploitative practices.
2. **Widespread Exploitation of Consumers:** Consumers are abused on a huge scale through a variety of unfair trade practices, and consumer protection is necessary to safeguard them.
3. **Unorganized Consumers:** Consumers in India are still unorganised, and there are few consumer organisations that would advocate for them.

### B. From Business Point of View:

1. **Business utilises societal resources:** Every business utilises societal resources, and it is their job to operate in the society's best interests.
2. **Long-term business interests:** It is in the business's best interests to keep its customers happy. Customers must be satisfied in order to win the global competition. Satisfied consumers lead to repeat purchases, which helps to expand the company's customer base.
3. **Government Intervention:** If a firm engages in any type of unfair commercial practices, the government will take action against it, harming the company's reputation.
4. **Social Responsibility:** A business has social duties to a variety of stakeholders, including owners, employees, the government, and customers. As a result, shoppers should be able to purchase high-quality goods at affordable pricing.
5. **Moral Justification:** Any firm has a moral obligation to behave in the best interests of its customers and prevent exploitation and unfair trade practices such as faulty and unsafe products, adulteration, false and misleading advertising, hoardings, black marketing, and so on.



## The Consumer Protection ACT, 2019:

Consumer Protection Act, 2019 is a law to protect the interests of the consumers. This act was inevitable to resolve a large number of pending consumer complaints in consumer courts across the country. It has ways and means to solve the consumer grievances speedily.



### Scope of the Act:

The scope of this act is broad and covers a wide range of activities. This act covers all the undertakings.

- Both large- and small-scale undertakings.
- All three sectors are covered, namely private, public, and cooperative.
- It is applicable to e-commerce companies as well.
- It is applicable to whole of India.
- All goods, services and trade practices are a part of this act, until specifically exempted.

### Legal Protection to Consumers:

1. **The Consumer Protection Act, 1986 (COPRA):** In this, it protects the right of the consumer and makes user aware of their rights. They have developed or formed three-tier system wherein there is District Forums, State Commission, and National Commission thus to protect the right of the consumer.
2. **Indian Contract Act, 1972:** The Indian Contract Act lays down the conditions that need to be fulfilled by the parties who contract in an agreement. This act regulates the buyers by keeping a legal check on their promise to sell authentic products to the seller. This Act protects the interest of both parties. It takes care that the contract is not breached, else respective remuneration has to be paid for such breach.
3. **The Sales of Goods Act, 1930:** This protects the rights of the consumers in case the products received by them are sub-standard.
4. **The Agricultural Produce (Grading and Marking) Act, 1937:** To implement the grading standard and hence monitoring the same whether standard checks are been done to issue the grading. In this, AGMARK is the standard introduced for agricultural goods.
5. **The Prevention of Fod Adulteration Act, 1954:** This act makes sure the purity of the food items and the health of the consumers which could be affected by the adulterated items.
6. **The Trade Marks Act, 1999:** This Act protects the consumers from the false marks which could mislead them to consume the product, and thus cheat on them by serving less qualified products.



### Rights of Consumers:

1. **Right to safety:** This rights includes concern for consumer's long term interest as well as for their present requirement.
2. **Right to Information:** consumer has the right to get information about the quality, purity, standard & price of the goods or services so as to protect himself against the abusive & unfair practices.





3. **Right to choose:** means to choose an assurance of availability, ability & access to variety of products & services at competitive price.
4. **Right to be heard:** if a consumer is exploited then he has the right to be heard and be assured that his interest would receive due consideration.
5. **Right to seek redressal:** The consumer has the right to seek redressal against unfair trade practices or any other exploitation.
6. **Right to consumer education:** it is the right of the consumer to acquire knowledge & skills to be informed to customers.
7. **Right to basic needs:** every citizen has the right to fulfil the basic needs to survive & have dignified living. The basic needs include food, clothing, health, etc.
8. **Right to healthy environment:** the consumers have the right to be protected against environmental degradation.

### Consumer Responsibilities:

#### CONSUMER RESPONSIBILITIES

Kinds of Consumer Responsibilities



Consumers have the following responsibilities:

1. **Be knowledgeable:** Be knowledgeable about the numerous items on the market so that you can make an informed and educated decision.
2. **Standardized products:** Purchase just standardized products to ensure quality. Look for the ISI mark on electrical goods, the FPO label on food products, and the Hallmark on jewellery, among other things.
3. **Follow Instructions:** Follow the product's instructions and learn about the hazards linked with it, then use it safely.
4. **Cautious Purchasing:** Carefully read labels for information on prices, net weight, manufacturing, expiration dates, and so on.
5. **Assert Yourself:** Assert yourself to guarantee that you obtain a fair bargain, and fair price of the product.
6. **Honesty:** Be truthful in interactions and buy only legal goods and services, thus discouraging buying from sellers who follow unethical methods such as black marketing and hoarding.
7. **Cash Memo:** When purchasing products or services, request a cash memo. This will serve as proof of the transaction.
8. **Consumer Societies:** Establish consumer societies that will actively participate in consumer education and protection.

## Who Can File a Complaint?

- A consumer.
- Any registered consumer association.
- The Central Government or any State Government.
- One or more consumers, on behalf of numerous consumers having the interest.
- A legal heir or representative of a deceased consumer.

## Ways and Means of Consumer Protection:

1. **Self-regulation by businesses:** Businesses that value corporate social responsibility adhere to ethical norms and practices while working with customers.
2. **Business associations:** The FICCI and the CII have established codes of conduct for its members to follow while interacting with clients.
3. **Consumer Awareness:** A well-informed consumer will be able to speak out against any unethical business activities.
4. **Consumer Organizations:** Consumer organisations play a vital role in informing consumers about their rights and protecting them.
5. **Government:** The government safeguards consumers' interests by establishing various consumer protection regulations.



## Redressal Mechanism Under Consumer Protection Act, 1986:

1. **DISTRICT FORUM:** District forum are set up in each district by the state concerned.  
**The important features are:**
  - a. It consists of a President and two members, one of whom should be a woman, duly appointed by State Govt.
  - b. It can receive consumer complaints of not more than Rs. 20 lakhs value.
  - c. On receiving the complaint, the district forum shall refer the complaint to the opposite party concerned and send the sample of goods for testing in a laboratory.
  - d. The district forum after being satisfied that goods are defective or there is some unfair trade practice can issue an order to opposite party directing him to either replace or return the price or pay compensation. In case the aggrieved party is not satisfied with the order of district forum. He can appeal before state forum within 30 days of passing an order.
2. **STATE COMMISSION:** It is set up in each state by the govt. concerned.  
**The salient features are:**
  - a. Each commission consists of a president and it least 2 members appointed by state Govt.
  - b. Complaints of at least Rs. 20 lakhs but not more than 1 crore can be filed with state commission.
  - c. On receiving the complaint, the state commission can also refer the complaint to opposite party and send the goods for testing in laboratory.
  - d. The state commission after being satisfied can order to opposite party to either replace or repay or pay compensation. In case the aggrieved party is not satisfied, they can appeal before national commission within 30 days of passing an order.



3. **NATIONAL COMMISSION:** It is setup by Central Govt.

**The provisions of act are:**

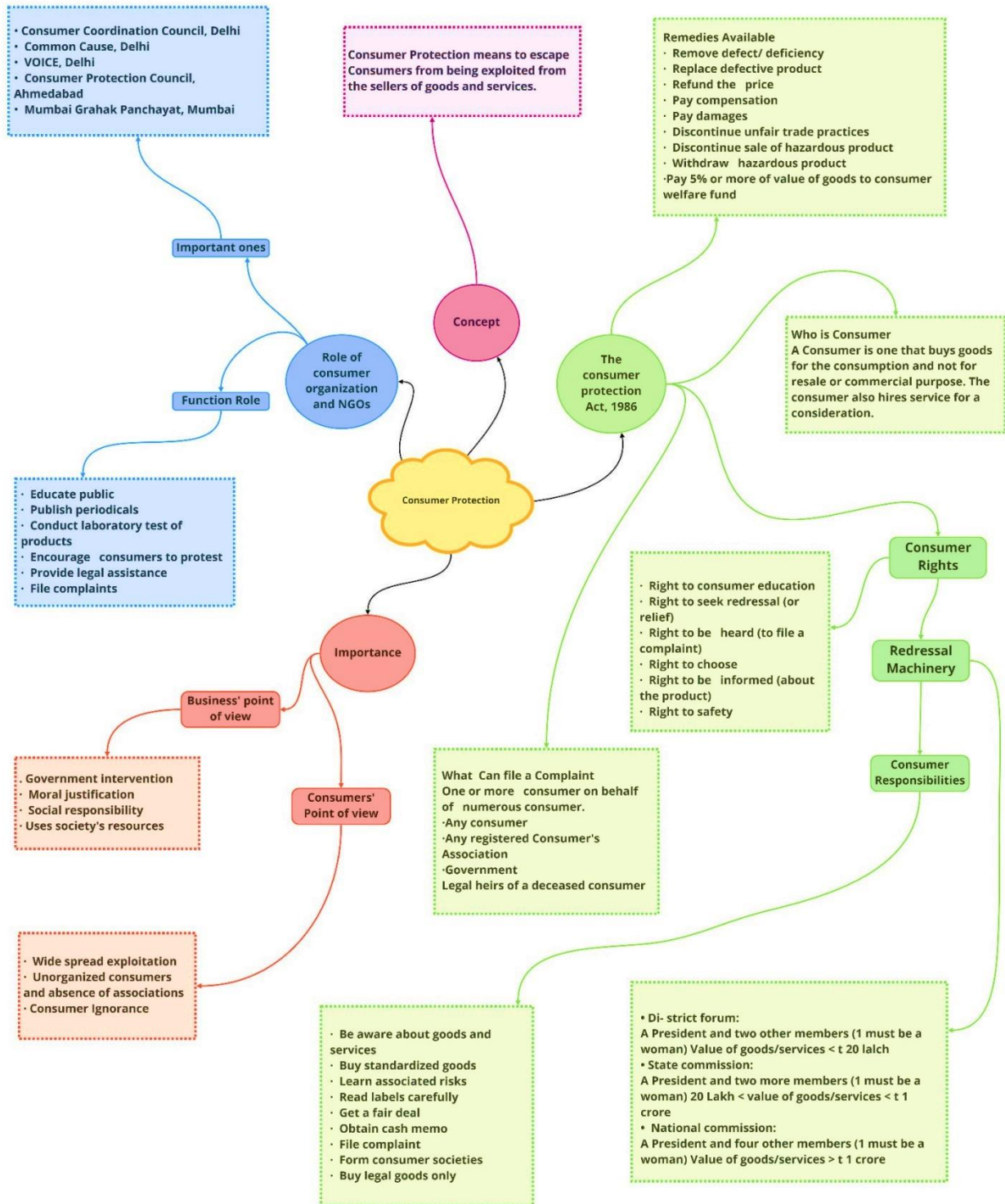
- a. It consists of a President and at least 4 members appointed by Central Govt.
- b. All complaints are pertaining to goods and services of value more than Rs. 1 crore can be filed with national commission.
- c. On receiving the complaint, the national commission can also refer it to opposite party and send goods for testing.
- d. The National Commission has the power to issue orders for replace mentor removal and to pay the compensation for loss.

**List of Consumer Organisations and Non-Governmental organisations (NGOs) working to defend and promote consumers' interests:**

- Consumer Coordination Council, Delhi.
- Common Cause, Delhi.
- Voluntary Organisation in Interest of Consumer Education (VOICE), Delhi.
- Consumer Education and Research Centre (CERC), Ahmedabad.
- Consumer Protection Council (CPC), Ahmedabad.
- Consumer Guidance Society of India (CGSI), Mumbai.
- Mumbai Grahak Panchayat, Mumbai.
- Karnataka Consumer Service Society, Bangalore.
- Consumers' Association, Kolkata.
- Consumer Unity and Trust Society (CUTS), Jaipur.

**STEP UP**  
ACADEMY

Class : 12th Business-studies  
Chapter - 12 : Consumer Protection





## Important Questions

### Multiple Choice Questions-

1. Who can file a complaint under the Consumer Protection Act, 1986?
  - (a) A legal her of a deceased consumer
  - (b) Any registered consumers association
  - (c) Any consumer
  - (d) All of the above
2. The consumer has a right to get relief in case of defective goods or deficient services as per the \_\_\_\_\_
  - (a) Right to be informed
  - (b) Right to choose
  - (c) Right to be heard
  - (d) Right to seek redressal
3. \_\_\_\_\_ means any person who buys any goods for personal use or hires or avails of any services for a consideration.
  - (a) Consumer
  - (b) Manufacturer
  - (c) Trader
  - (d) Service Provider
4. A complaint can be filed against \_\_\_\_\_ who adopt(s) unfair trade practices.
  - (a) Trader only
  - (b) Manufacturer only
  - (c) Trader and Manufacturer
  - (d) Consumer
5. Consumers should use ISI marked electrical appliance is an example of
  - (a) Right to be informed
  - (b) Right to safety
  - (c) Right to choose
  - (d) Right to be heard
6. In case an aggrieved consumer is not satisfied with the decision of the State Commission, he can make a further appeal in
  - (a) National Commission
  - (b) District Forum
  - (c) Supreme Court of India
  - (d) All of the above
7. In case a consumer is not satisfied with the order passed in the State Commission, he can further make an appeal in the National Commission within a time period of
  - (a) 10 days
  - (b) 20 days
  - (c) 30 days
  - (d) 45 days
8. A consumer has a right to file a complaint and to be heard in case of dissatisfaction with goods or services according to the \_\_\_\_\_
  - (a) Right to Seek redressal
  - (b) Right to choose
  - (c) Right to be heard
  - (d) None of the above
9. \_\_\_\_\_ is set up by the Central Government
  - (a) State commissions
  - (b) District forum
  - (c) National commission
  - (d) None of the above
10. \_\_\_\_\_ A standardised mark is printed on jewellery.
  - (a) Agmark
  - (b) ISO 2009
  - (c) ISI
  - (d) Hallmark
11. Which of the following statements is not true with regard to the National Commission?
  - (a) It consists of a President and at least five other members, one of whom should be a woman.
  - (b) The members are appointed by the Central Government.
  - (c) A complaint can be made to the National Commission when the value of the goods or services in question, along with the compensation claimed, exceeds crore.
  - (d) Where the aggrieved party was not satisfied with the order of the National Commission, the case can be taken to the Supreme Court of India.

12. \_\_\_\_\_ mark is used for electrical products.
- ISI
  - FPO
  - ISO
  - Agmark
13. \_\_\_\_\_ are set up in each district by the State Government concerned.
- District Forums
  - National Commission
  - State Commission
  - None of the above
14. The state commissions are set up in each state by \_\_\_\_\_
- Supreme court
  - High court
  - Central Government
  - State Government
15. Consumers can ask anything regarding date of manufacture, price, quantity etc., is an example of \_\_\_\_\_
- Right to be informed
  - Right to choose
  - Right to safety
  - Right to be heard

### Very Short-

- Which consumer right gives the business firms freedom to set up their own consumer service and grievance cells?
- Mention when as a consumer you are not in a position to resolve your grievance under consumer protection act.
- Sandeep purchased a diesel car for Rs. 7 lacs from an automobile company and found its engine defective. Despite many complaints the defect was not rectified. Suggest to him the appropriate authority where he could file a complaint under consumer protection Act.
- A co. is using sub- slandered electric wiring in its coolers. Which consumer right is being violed?
- Which document serves as an evidence of purchase?
- Rita wants to buy a packet of juice .As an aware customer how can she be sure about the quality of juice she palns to buy?
- What is the quality mark provided to agricultural commodities and live stock products?
- Name any two NGO's engaged in protecting and promoting consumer's interest.

9. Saroj wants to file a complaint where the value of goods or services in along with the compensation claimed amounts to 25 lakhs.

### Short Question-

- Mr. Soni a consumer purchased medicines without noticing the date of expiry . He also did not obtain the cash memo. Do you think he will be able to protect himself by the loss caused due to expired medicines ? give reasons in support of your answer?
- Mr. Verma who was a vegetarian went to a snack bar for having French fries and later found out that it had non-vegetarian content. Neither the advertisement nor the packing of the product displayed that the product has non-vegetarian content. Will Mr. Verma be able to claim compensation which right of the consumer is violated here?
- As a well informed consumer. what kind of quality certification marks you will. Look for before buying 'products? Specify any 6.
- A shopkeeper sold you some spices, claiming that they were pure. Later a laboratory test formed that those were adulterated what precautions should you have taken before buying and what remedies are available to you for the wrong act?
- What is the provision regarding enforcement of the orders of District Forum, State Commission, or National Commission?
- What are the Penal Provision under Consumer Protection Act?

### Long Question-

- What are various prescribed authorities under the consumer protection Act, 1986? Describe their composition, object, and procedure for the meeting.
- Define the following terms
- What is the need and importance of the consumer protection Act in India?
- Explain the problems of consumers under the Consumer Protection Act.

### Case Study Based Question-

- Indian Youth Organisation (IYO) organised a visit of its members to an old age home to inculcate the habit of social work among them. The visit revealed that the living conditions of the inmates of the old age home were not hygienic. So, the IYO



members decided to clean the premises. During their cleanliness drive, they realised that the old age home also required pest control. But some of the inmates of old age home were reluctant for it because they believed that the pest control may create health problems for them. IYO, therefore decided to provide ethical, safe and odourless pest control. They showed to the inmates of old age home a pamphlet of the proposed pest control product which promised easy, inexpensive and long lasting pest control. The inmates happily agreed and the pest control was carried out. It worked for a fortnight but to their dismay the effect started wearing off. IYO contacted the pest control company which kept on postponing their visit. After waiting for a month, IYO filed a case in the consumer court.

- a. The consumer court was satisfied about genuineness of the complaint and issued necessary directions to the pest control company.
  - b. State the six directions that might have been issued by the court.
  - c. Also identify any two values that are being communicated by IYO to the society.
2. Aman, a degree holder in Entrepreneurship came to know about Piplantri Village located in Rajasthan, where in 2006 an initiative was started in which 111 trees are planted every time a girl child is born.

To keep termites away from the trees the villagers have planted 2.5 million Aloe Vera plants around the trees. This has turned the village into an oasis, as the planting of trees led to higher water levels.

Aman decided to visit the village to start a business unit, for the processing and marketing of Aloe Vera into juices, gels and other products.

However, on visiting the village Aman found that the villagers were suffering exploitation at the hands of local merchants who were engaged in unscrupulous, exploitative trade practices like hoarding and black marketing of food products and also selling unsafe and adulterated products to the villagers.

After looking at their plight, instead of a business organisation, he decided to set up an organisation for the protection and promotion of the consumer interest of the villagers.

State the functions that the organisation established by Aman will be performing. (Any six points).

### Assertion Reason Question-

1. In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.
  - a. Assertion and reason both are correct statements and reason is correct explanation for assertion.
  - b. Assertion and reason both are correct statements but reason is not correct explanation for assertion.
  - c. Assertion is correct statement but reason is wrong statement.
  - d. Assertion is wrong statement but reason is correct statement.

**Assertion (A):** 'Right to be Informed' is important for a safe and secure life.

**Reason (R):** According to this right, the consumer has a right to be protected against goods and services which are hazardous to life, health and property.

2. In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.
  - a. Assertion and reason both are correct statements and reason is correct explanation for assertion.
  - b. Assertion and reason both are correct statements but reason is not correct explanation for assertion.
  - c. Assertion is correct statement but reason is wrong statement.
  - d. Assertion is wrong statement but reason is correct statement.

**Assertion (A):** According to Right to Choose, Marketers should not force the consumer to buy a particular brand.

**Reason(R):** Every consumer has the right to choose from a variety of goods and services at competitive prices.



## Answer Key

### MCQ Answers-

1. **Answer:** (d) All of the above
2. **Answer:** (d) Right to seek redressal
3. **Answer:** (a) Consumer
4. **Answer:** (c) Trader and Manufacturer
5. **Answer:** (b) Right to safety
6. **Answer:** (a) National Commission
7. **Answer:** (c) 30 days
8. **Answer:** (c) Right to be heard
9. **Answer:** (c) National commission
10. **Answer:** (d) Hallmark
11. **Answer:** (a) It consists of a President and at least five other members, one of whom should be a woman.
12. **Answer:** (a) ISI
13. **Answer:** (a) District Forums
14. **Answer:** (d) State Government
15. **Answer:** (a) Right to be informed

### Very Short Answer-

1. **Ans.** Right to representation.
2. **Ans.** As a consumer we are not in a position to resolve our grievances when we have not fulfilled the responsibilities of a consumer.
3. **Ans.** District Forum.
4. **Ans.** Right to safety.
5. **Ans.** "Cash Memo."
6. **Ans.** Rita can check for FPO (Fruit product order 1955) certifications. She can check the date of manufacture and expiry and check the storage / display conditions.
7. **Ans.** AGMARK.
8. **Ans.** (a) Consumer co-ordination council ,Delhi  
(b) Consumers Association, Kolkata.
9. **Ans.** State Commission.

### Short Answer-

1. **Ans.** In the given case, Mr. soni as a consumer was not able to fulfill his responsibility at two fronts.  
(I) He didn't go through the packing specifications mentioned on the product at the time of purchase.

(II) Most importantly, he did not obtain the cash memo from the surer. A cash memo is a proof of purchase and it is must for filing any complaint.

Hence, he will not be able to protect himself by the loss caused due to expired medicines.

2. **Ans.** In the given case there is violation of the consumer right to know .Acc. to the amendment of the regulations in weight and measurement Act.(2000) every product should explicitly bear a green dot for vegetarian ingredients while brown reveals that non-vegetarian ingredients have been used. It is also mandatory to show the dot on an advertisements electronic or press and all posters ,banners ,stunts etc. hence Mr. Bharti would be able to claim the compensation.
3. **Ans.** Some of the quality certification marks are:
  - (1) **FPO( Fruit Products Order 1955):** It contains specification and quality control requirements regarding the production and marketing of processed fruits and vegetables ,sweetened aerated water, vinegar and synthetic syrups.
  - (2) ISI- On consumer durable products.
  - (3) Hall mark- BIS certification scheme for gold jewellery items.
  - (4) Earthen Pitcher –For Labeling Environment friendly products
  - (5) AGMARK – It is a grade standard for agricultural commodities and like stock products.
  - (6) Wool mark- It signifies 100% pure wool.
4. **Ans.** We should have been conscious about quality and should obtain cash memo from the seller while purchasing goods. The remedies available are:
  - (1) Getting the product replaced.
  - (2) Getting the refund of the price.
  - (3) Compensation.
5. **Ans.** Following are the provision regarding enforcement of orders of redressal agencies
  1. Every order of (Redressal Forum, the Agency Commission, or National



Commission) shall be a bind if no appeal has been preferred against such order under the provision of this Act.

2. No redressal agency shall admit a complaint unless it is filed within 2 years from the date on which the cause of action has arisen (Sec. 24 A (1)).
3. A complaint may be entertained for the period specified above If the complaint satisfies that he had sufficient cause for not filing the complaint within such period [Sec. 24 A (2)].

It is worth mentioning that such delay can be condoned only when the reasons are recorded.

4. Every order made by such agency will be executed in the same way as the court, to which it is sent, shall execute as if it were decree or order sent to it for execution. (Sec. 25).
5. If the redressal agency fails to get its order executed, then it will send the order to the court in whose jurisdiction the dispute falls for its execution. Then the said court shall execute the order as if it were a decree or order sent to it for execution.

#### Jurisdiction is decided as under:

- If the order is against a company, the jurisdiction will be divided on the basis of the place of the registered office of the company.
  - If the order is against any person, the jurisdiction will be decided according to the place where the person concerned voluntarily resides or carries on business, or personally works for gain (Sec. 25)
6. When a complaint is put up before these agencies it is found to be frivolous or vexatious, it shall, for a reason to be recorded in writing, dismiss the complaint.

It can also be made an order that the complaint shall pay to the opposite party such cost, not exceeding ten thousand rupees, as may be specified in the order.

6. **Ans.** According to Sec. 27, where a trader or a person against whom a complaint is made, or the complainant, fails to comply with any order made by the District Forum, the State Commission, or

National Commission, as the case may be, such traders or person or complainant shall be punishable

- with imprisonment for not less than one month but which may extend to 3 yrs; or
- with fine which shall be not less than Rs. 2000 but which may extend to Rs. 10,000; or
- with both.

In case, the redressal agency is satisfied with the circumstances of the case, it can reduce the minimum limits of both imprisonment or fine, mentioned above.

### Long Answer -

1. **Ans.** Authorities under the Act as follows:

1. **The Central Consumer Protecting Council (Sec. 4 (1)):** This section provides provision for the establishment of the Central Consumer Protection Council (now Central Council) by the Central Government. The Central Government may issue a notification in this regard and may specify the date of establishment of such council in the notification.

**Composition (Sec. 4(2)):** The Central Council shall consist of the following members

1. The Minister-in-Charge of consumer affairs in Central Government, who shall be its chairman, and
2. Such member of other official or non-official members as may be prescribed.
3. The Minister of State of Consumer Affairs in Central Government as Vice-Chairman of Council;
4. The Minister of Food and Civil Supplies or Minister-in-Charge of Consumer Affairs in State.
5. 5 members from Lok Sabha and 3 members from Rajya Sabha.
6. The Secretary of National Commission for Scheduled Castes and Scheduled Tribes;
7. Up to 20 representatives of the Central Government Department and autonomous organization concerned with consumer interest;

8. At least 35 representatives of the Consumer Organisation concerned with consumer interest.
9. Not less than 10 representatives of women.
10. Up to 20 representatives of farmers, trade, and industries.
11. The Secretary in Department of Civil Supplies shall be the Member Secretary of Central Council.

The object of Central Council (Sec. 6) The Central Council shall work with the objective to promote and protect the rights of consumers.

Terms of Council Term of Council shall be 3 years. A member may resign by submitting his written resignation to the chairman, the vacancies shall be filled from the same category by the Central govt, and such person shall hold office so long as the original member would have been entitled to hold office. The Central govt may constitute a standing working group from amongst the member of the council to monitor the implementation of the recommendation of the council.

Procedure for Meeting of Central Council (Sec. 5) The council shall meet as and when necessary, but at least one meeting of the council shall be held every year. The meeting shall be held at such place and at such time as the chairman may think fit.

2. **The State Consumer Protection Council (Sec 7(1)):** This section authorizes the State Government to establish a Consumer Protection council by issuing a notification in this regard and with effect from such date as it may specify in the notification.

**Composition Sec 7 (2):** The State Council shall consist of the following members

1. The Minister-in-Charge of Consumer Affairs in State Government as its chairman.
2. Such member of other official or non-official members, representing various interest, as may be prescribed by State Government; and

3. Up to 10 other official or non-official member nominated Objects of Council (Sec. 8) The objective of every state council shall be to promote and protect the rights of consumers as laid down in clauses (i) to (v) of section 6 within the state.

The procedure of Meeting (Sec 7 (4)): The State Council shall meet as and when necessary, but at least 2 meetings should be held every year. It shall meet at such time and place as the Chairman may think fit and observe such procedure which is prescribed by State Government for the transaction of its business.

3. The District Consumer Protection Council (Sec 8 A): This section was inserted in 2002 in Act by making amendment in it. ACU to the Section, the State Govt, shall establish District Consumer Protection Council for every district with effect from such date as is specified in the notification.

**Composition:** The District Council shall consist of the following members:

- the Collector or Deputy Commissioner as its chairman; and
- such member of other official or non-official members representing such interest as may be prescribed by State Government.

**The object of Council (Sec. 8B):** The District Council shall work with the objective of promoting and protecting the rights as specified in clauses (i) to (vi) of sec. 6 with the jurisdiction of the district.

**Procedure for Meeting:** The District Council shall meet as and when necessary, but at least 2 meetings should be held every yr. It shall meet at such time and place as the Chairman may think fit and observe such procedure which is prescribed by State Govt, for the transaction of its business.

2. **Ans. (a) Consumer:** Acc. to Consumer Protection Act, 1986, 'Consumer' means a person who:
  1. Buys any goods for the 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 goods for consideration paid or 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, (Sec 2(l) d 0).

2. Hires of avails of any services for a consideration which has been paid or promised or partly paid or promised, or under any system of deferred payment and includes any beneficiary of such services other than the person who hires or avails of services for consideration paid or promised, or under any system of deferred payment, when such services are availed of with the approval of the first-mentioned person.

Explanation Please note that the consumer also includes the user of goods or beneficiary of services when such goods or services are used or availed with the permission of the main buyer.

Also, the consumer does not include a person who uses the goods or services for the purpose of resale or any other commercial purpose.

But note that, 'commercial purpose' doesn't include used by him exclusively for the purpose of earning his livelihood, by means of self-employment.

- (b) Complaint 'Complaint' means any allegation in writing made by a complainant that:
  1. an unfair trade practice or a restrictive trade practice has been adopted by any trader;
  2. the goods, brought by him or agreed to be brought by him, suffer from one or more defects;
  3. the services, hired or availed of or agreed to be hired or availed of by him, suffer from a deficiency in any respect;
  4. A trader has charged for the goods, mentioned in the complaint, a price in excess of the price fixed by or under any law for time being in forces or displayed on the goods or any package containing such goods.

5. Goods, which will be hazardous to life and safety when used, are being offered for sale to the public in contravention of permission of any law for time; being in forces requiring traders to display information in regards to contents, manner, and effect of the use of such goods (sec 2 (1) (c)).

(c) **Complainant:** Any person or institute mentioned below who files a complaint is called the complainant

1. A consumer or
2. Any voluntary consumer association registered under the Indian Companies Act, 1956 or any Voluntary Consumer Association registered under other Act in force in the country.
3. The Central or State govt., who or which makes a complaint.
4. In the case of numerous consumers having the same interest, one or more than one consumer.
5. In case of death of a consumer, his legal heir or representative, who or which makes a complaint (Sec 2(1) (b)).

(d) **Manufacturer:** It means the person who:

1. makes or manufacture any goods or parts thereof,
2. does not makes or manufacture any goods but assemble parts thereof made or manufactured by others and claims the end-product to the goods manufactured by himself, or
3. puts or causes to be put his own mark on any goods to be made or manufactured by, any other manufacturer and claims such goods to be made or manufactured by himself (sec 2(i)).

Explanation Where a manufacturer dispatches any goods or part thereof no any branch office maintained by him, such branch shall not be deemed\* to be manufactured even though the parts so dispatched to it as assembled at such office and are sold or distributed from such branch office.

3. **Ans.** Need and Importance of Consumer Protection Act can be explained as follows:
1. **Unfair and Deceptive Trade Practices:** In case of unfair and deceptive trade practices, such as selling of defective or sub-standard goods, ignoring safety standards, charging exorbitant prices, misrepresenting the efficiency or usefulness of goods, etc. Consumer Protection Act makes producers/traders more accountable to consumers. It also becomes inevitable for consumers to unite at a common platform to deal with issues concerning consumer protection.
  2. **Lengthy Legal Process:** The violation of various Acts by traders/producers means an ordinary consumer has no other remedy but to initiate action by way of a civil suit which involves a lengthy legal process proving to be too expensive and time-consuming. In fact, very often the time, cost, and mental tension involved in the legal process is disproportionate to compensation claimed and actually granted to individual consumers. Therefore, it becomes necessary to involve laws directed at protecting the consumers providing for remedies that are simpler, more accessible, quicker, and less expensive.
  3. **Impact of other countries:** the USA, European Union, Australia, etc. have taken effective and strict measures to protect the interest of consumers. Following these countries, India has also felt the necessity of consumer's protection.
  4. **Welfare State India is a welfare state:** One of the Directive Principles enshrined in the Indian Constitution is that state shall direct its policy towards securing that operation of economic system does not result in the concentration of wealth and means of production to determinantal to common man-keeping in view the consumer interest, Govt, passed Monopolies and Restrictive Trade, Practices Act, 1969. Later on, in 1984, provisions relating to unfair trade practices were also incorporated in Act. wide powers have been granted to the HRTP commission under the Act to control and prohibit monopolistic, restrictive, and unfair trade practices.
  5. **Economic Development:** During 55 years of planning in India, there is a spectacular change in the standards of living. The structural and institutional changes in the economy consequent upon Economic Reforms 1991 clearly indicate that there has been modernization and globalization of the economy wants of the consumers have increased manifold. Hence, the need for safeguarding consumer's interests has also grown and has become more important.
  6. **Means of transport and communication:** The rapid growth of means of transport and communication has brought the world consumers together. There is a strong 'demonstration effect' through Mass media of TV/ cable network that has made the consumers aware that they can no longer be exploited by the business community and kept isolated from other countries as far as their right to safety and health are concerned.
  7. **Role of Judicial System:** Consumer Protection Act, 1986 has vested vast powers to the Supreme Court for the protection of consumer rights, their safety, and health. As a breakthrough, the remedies for consumer protection are now simpler, more accessible, quicker, and less; expensive.
  8. **LokAdalats:** The concept of Lok Adalat in India is catching up fast. They have become part of a speedy, effective, and economical redressal system. Interesting to note, lakhs of cases relating to motor accidents, complaints diagrams Ltd. Delhi Electric Supply Undertaking have been settled involving crores of rupees. The concept of Lok Adalats has now been extended to other areas.
  9. **Concept of Public Interest Litigation (PIL):** For consumer protection, a large number of petitions by way of PIL have been filed before High Courts and Supreme Court. The concept of PIL is catching fast. Under PIL, it is not only the aggrieved person, but any person can move to court in the interest of the weak or a group who or which may not be in a position to seek legal remedy on his own. " Secondly, a complaint sent to Supreme Court even on postcard may be treated as a writ petition. PIL is virtually



consumer interest litigation which has helped a lot in the cause of consumer protection.

10. **Consumer Awareness:** The spread of education especially higher education has made people aware of their rights as consumers. The relief granted to consumers and important judicial decisions regarding consumer protection or relief is often covered by newspaper. Rising income has increased the purchasing power of people to spend more. The rise in prices of products has created in consumer an attitude to expect better quality or, at least to expect the product to be worth their money. Consumers expect better services for their durables. Legislation leading to consumer protection has created an awareness among consumers about their rights and remedies available to them.
11. **Consumer organizations:** There are more than 500 consumer organizations in India. These consumer organizations are performing a number of functions such as bringing out vouchers, journals, monographs, collecting data of different talks, seminars, workshops, and conferences for the purpose of focusing on the problems of consumers and finding solutions thereof.
4. **Ans.** Due to illiteracy, poverty, lack of information, etc. consumers has to face many problems every day. They tolerate silently all these because their outlook being traditional, They remain ignorant of their rights. Following are the problems under the Consumers Protection Act

1. **Unfair Trade Practices:** Trade communities are engaged in various activities to increase their sale and change their economic use or to provide some services. They may devise any unfair method viz. false and misleading advertisement, free gifts, lucky draws. They falsely represent that the services are of particular quality or grade. Following are the unfair trade practice.

- (a) **False and misleading Advertisement:** Trade community spends a lot of money on the advertisement of their goods and services but most of these are false and

misleading. These are exaggerated and based on unprovable claims. They make advertisement of products of poor quality's special standard product.

- (b) **Free gifts and Prizes:** The offering of gifts, prizes, or other items with the intention of the net providing there as offered or creating an impression that something is being given or offered free of charge when it is fully or partly covered by the amount charged in the transaction as a whole is treated as unfair trade practice.
2. **Spiralling price:** The prices of the product are unduly hiked by the {roducers. The rising prices are the result of anti-social activities viz hoarding, black marketing, and creating of artificial scarcity of the product. It leads to consumer exploitation and victimization.
3. **Adulteration:** It is a big consumer problem. Sometimes, it is very hazardous to health. The traders resort to many sources to earn high profits. Mixing animal fat with ghee, harmful seeds with grains and pulses, mustard oil with mineral oil are some of the adulterations.
4. **Poor quality products:** Sale of poor quality products and sub-standard products is also a part of consumer exploitation. The manufacturer makes the declaration that the product is 'Agmark' is not sufficient. There is no matter missing to verify that the goods sold to consumers conform with a specification of safety. It results in a large number of the death by using sub-standard products and unsafe domestic products like a pressure-cooker, kerosene stoves, etc.
5. **Deceptive packing:** Many times traders resort to practicing to deceive consumers. They put the smaller quantity of products in a packet or change the spelling of reputed product slightly like Tata Teas, the name 'Tata Tea' etc.
6. **Underweight supplies:** Underweight goods by the trader to the consumer, For example, each LPG cylinder must contain 14.2 kgs. of gas but many times underweight cylinders are supplied to customers.

7. **Deficiency in Services:** Deficiency in Services is also a form of customer problem for instance
  - Under delay in courier service
  - wrong billing by electricity and telephone departments
  - under delay in setting insurance accident claims.
8. **Negligence in services:** It is another cause of consumer exploitation, For instance, wrong operations by a surgeon. Many of these incidents are published in newspapers very often.
9. **Monopolistic trade practices:** Monopolistic is that market condition in which there is a single seller of a certain product in the market so he is in the position to exploit the consumer by charging high prices and low quality of product etc.

### Case Study Answer-

#### 1. Answer:

- a. The six directions that might have been issued by the court are as follows:

##### Reliefs available to a consumer

- To remove the deficiency in service.
- To refund the charges paid for the service.
- To pay a reasonable amount of compensation for any loss or injury suffered by the consumer due to the negligence of the opposite party.
- To discontinue the unfair/restrictive trade practice and not to repeat it in the future.
- To pay any amount (not less than 5% of the value of the defective goods or deficient services provided), to be credited to the Consumer Welfare Fund or any other organisation/person, to be utilised in the prescribed manner.

- b. To issue corrective advertisement to neutralise the effect of a misleading advertisements.
- c. The two values that are being communicated by IYO to the society are:
  - Social service
  - Promoting health and hygiene

#### 2. Answer:

Aman has set up an NGO or consumer organization in the village for the protection and promotion of the consumer interests.

The key functions highlighting the role of a consumer association are listed below:

- Educating the general public about consumer rights by conducting training programmes, conferences and workshops.
- Publishing periodicals and other publications to give knowledge about consumer problems, legal reporting, reliefs available and other matters of interest.
- Carrying out comparative testing of consumer products in accredited laboratories to test relative qualities of competing brands and publishing the test results for the benefit of consumers.
- Encouraging consumers to strongly protest and take an action against unscrupulous, exploitative and unfair trade practices of sellers.
- Providing legal assistance to consumers by way of providing aid, legal advice etc. in seeking legal remedy.
- Filing complaints in appropriate consumer courts on behalf of the consumers.

### Assertion Reason Answer-

1. d. Assertion is wrong statement but reason is correct statement.
2. a. Assertion and reason both are correct statements and reason is correct explanation for assertion.

