



**PRAGASHA EDUCATION, RESEARCH AND DEVELOPMENT
CENTRE FOR SOCIAL SCIENCES AND HUMANITIES**

**NTA UGC NET
ONE DAY SPECIAL ORIENTATION PROGRAMME
For Paper – II (Commerce)**

FOR UGC NET & JRF ASPIRANTS

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STUDY MATERIAL

RESOURCE PERSON

**Mr. N.Vikram, M.Com, MBA, M.Phil, UGC- NET
UGC NET TRAINER
PRAGASHA**

ORGANISED BY

**Dr.M.P.Suganya, M.Com, M.Phil, Ph.D, UGC-NET
Course Coordinator**

**PRAGASHA EDUCATION, RESEARCH & DEVELOPMENT
CENTRE FOR SOCIAL SCIENCES & HUMANITIES**

**II Floor, New No.48/Old No. 16, Alagiri Nagar, 3rd Street,
Vadapalani, Chennai – 600 026
Contact No – 99401 45568**



Dear Friends,

Greetings!!!

Just I would like to share few quotes with you...

- Stay Positive, Work Hard, Make It Happen....
- *Don't Stress. Do Your Best. Forget the Rest...*
- *Never Give Up on Yourself...*
- **Success** Doesn't Come to You, **YOU GO TO IT...**
- **AMBITION** is important than **ENTERTAINMENT...**
- **No. 1** Can Defeat YOU....
- *To Cut Down a Tree in Five Minutes, Spend Three Minutes Sharpening Your Axe. Success Begins with Preparation – Test Preparation...*

Some of them are my favourite positive quotes,

Some of them, I have created on my own...

You know I'm a Good Dreamer, I dream it, to make things happen... PRAGASHA is a Dream, Gold Medal is a Dream, Ph.D is a Dream, Best Performer is a Dream, Qualifying NET is a Dream, Now Dreaming to be a Teacher, Let see (Sooner, I may take that Avatar)...

I hate Negativity, I stay away from negative people, I stay silent with them, but even to them I say I Can Do It, I will do it... When I Can do it, you can also do...

First, NET Exam is not as tough as you think, you have to plan it, do you know what I did – first complete analysis of question paper, based on that I understood the syllabus, I started solving the previous year question papers and evaluated it... With the results, I prioritised the strong subject. I just given less importance to weak subjects while preparing. Note - less importance – I'm not good at Finance, I left all finance related subjects. I given more importance on Strong Subjects. This is my strategy... Strategy may differ person to person... So, plan your own strategy, As quick as possible...

This book covered all subjects, but this material alone will not be sufficient for NET EXAM preparation, Refer a standard text book for every subject. this is completely compiled material from various books and online resources. ***Put your heart, mind, intellect and soul even into your smallest acts. This is the secret of Success...***

Thanks & Regards

Dr.M.P.Suganya

Founder & Managing Director

PRAGASHA

UGC NET EXAMINATION

SYLLABUS - COMMERCE (Code – 08)

Unit – 1: Business Environment

- ✓ Meaning and Elements of Business Environment
- ✓ Economic Environment, Economic Policies, Economic Planning
- ✓ Legal Environment of Business in India, Competition Policy, Consumer Protection, Environment Protection
- ✓ Policy Environment: Liberalisation, Privatisation and Globalisation, Second Generation Reforms, Industrial Policy and Implementation, Industrial Growth and Structural Change.

Unit – 2: Financial & Management Accounting

- ✓ Basic Accounting Concepts, Capital and Reserves, Financial Statement
- ✓ Partnership Accounts: Admission, Retirement, Death, Dissolution and Capital Distribution
- ✓ Advanced Company Accounts: Issue, Forfeiture, Purchase of Business, Liquidation, Valuation of Shares, Amalgamation, Absorption and Reconstruction, Holding Company Accounts
- ✓ Cost and Management Accounting: Ratio Analysis, Fund Flow Analysis, Cash Flow Analysis, Marginal Costing and Break Even Analysis, Standard Costing, Budgetary Control, Costing For Decision Making
- ✓ Responsibility Accounting

Unit – 3: Business Economics

- ✓ Natural and Uses of Business Economics, Concept of Profit and Wealth Maximization. Demand Analysis and Elasticity of Demand, Indifference Curve Analysis
Law of Utility Analysis, Law of Return and Law of Variable Proportions
- ✓ Cost, Revenue, Price Determination in Different Market Situation: Perfect Competition, Monopolistic Competition, Monopoly, Price Discrimination and Oligopoly, Price Strategies

Unit – 4: Business Statistics and Data Processing

- ✓ Data Types, Data Collection and Analysis, Sampling, Need, Errors and Methods of Sampling, Normal Distribution, Hypothesis Testing, Analysis and Interpretation of Data
- ✓ Correlation and Regression, Small Sample Tests – T-Test, F -Test and Chi Square Test
- ✓ Data Processing - Elements, Data Entry, Data Processing and Computer Application
- ✓ Computer Application to Functional Areas – Accounting, Inventory Control And Marketing

Unit – 5: Business Management

- ✓ Principle of Management
- ✓ Planning - Objective, Strategic, Planning Process, Decision Making
- ✓ Organising, Organisational Structure, Formal and Informal Organisation, Organisational Culture
- ✓ Staffing
- ✓ Leading: Motivation, Leadership, Committees, Communication
- ✓ Controlling
- ✓ Corporate Governance and Business Ethics



Unit - 6: Marketing Management

- ✓ The Evolution of Marketing, Concept of Marketing, Marketing Mix, Marketing Tasks, Concepts and Tools, Marketing Environment
- ✓ Consumer Behaviour, Market Segmentation
- ✓ Product Decision
- ✓ Pricing Decisions
- ✓ Distribution Decision
- ✓ Promotion Decisions
- ✓ Marketing Planning, Organising and Controlling
- ✓ Marketing Research
- ✓ Online Marketing

- ✓ Direct Marketing: Social, Ethical and Legal Aspect of Marketing in India

Unit - 7: Financial Management

- ✓ Capital Structure, Financial and Operating Leverage
- ✓ Cost of Capital, Capital Budgeting
- ✓ Working Capital Management
- ✓ Dividend Policy

Unit – 8: Human Resource Management

- ✓ Concepts, Role and Function of Human Resource Management
- ✓ Human Resource Planning, Recruitment and Selection
- ✓ Job Analysis, Job Description and Specifications, Use of Job Analysis Information
- ✓ Training and Development, Succession Planning
- ✓ Compensation: Wage and Salary Administration, Incentive and Fringe Benefits, Morale and Productivity
- ✓ Performance Appraisal
- ✓ Industrial Relations in India, Health, Safety, Welfare and Social Security, Worker's Participation in Management
- ✓ Concept: Role and Functions of Human Resource Management



Unit - 9: Banking and Financial Institution

- ✓ Importance of Banking to Business, Types of Banking and Their Functions, Reserve Bank of India, NABARD and Rural Banking
- ✓ Banking Sector Reforms in India, NPA, Capital Adequacy Norms
- ✓ E-Banking
- ✓ Development Banking: IDBI, IFSC, SFCs, UTI, SIDBI

Unit – 10: International Business

- ✓ Theoretical Foundations of International Business, Balance of Payments
- ✓ International Liquidity, International Economic Institutions - IMF, World Bank, IFSC, IDA, ADB

- ✓ World Trade Organisation - Its Functions and Policies
- ✓ Structure of Indian Foreign Trade: Composition and Direction, EXIM Bank, EXIM Policy of India, Regulations and Promotion of Foreign Trade
- ✓ Foreign Direct Investment and Multinational Corporation - MNCs Culture, MNCs and LDCs, Joint Ventures
- ✓ Regional Economic Integration: SAARC, ASEAN, EC, NAFTA
- ✓ India and WTO, Intellectual Property Rights
- ✓ Foreign Exchange - Exchange Rate, Mechanism, Risk Management, Transfer of International Payments, Convertibility of Rupee, Current and Capital Accounts, Issues and Perceptions, Derivatives And Futures
- ✓ Foreign Investment Institutions; Instruments: GDRs, ADRs, FIIs – their Role in Indian Capital Market

Unit – 11: Accounting and Finance

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- ✓ Accounting Standards in India, Inflation Accounting, Human Resource Accounting, Responsibility Accounting, Social Accounting
 - ✓ Money and Capital Market, Working of Stock Exchange in India, NSE, OTCEI, NASDAQ, Derivatives and Options
 - ✓ Regulatory Authorities: SEBI, Rating Agencies, New Instruments: GDRs, ADRs
 - ✓ Venture Capital Funds, Merger and Acquisitions, Mutual Funds, Lease Financing, Factoring, Measurement of Risk and Return, Securities and Portfolios
 - ✓ Computer Application in Accounting and Finance

Unit – 12: Income Tax Law and Tax Planning

- ✓ Basic Concepts, Residential Status and Tax Incidence, Exempted Incomes, Computation of Taxable Income under Various Heads
- ✓ Computation of Taxable Income of Individuals and Firms
- ✓ Deduction of Tax, Filing of Returns, Different Types of Assessment, Defaults and Penalties
- ✓ Tax Planning: Concept, Significance and Problems of Tax Planning, Tax Evasion and Tax Avoidance, Methods of Tax Planning

- ✓ Tax Consideration in Specific Business Decision viz., make or buy; own or lease; retain or replace; Export or Domestic Sales; Shut-down or Closure; Expand or Contract; Invest or Disinvest
- ✓ Computer Application in Income Tax and Tax Planning

NOTE:

- ❖ **There is NO Changes in the UGC SYLLABUS. In this syllabus, added elective papers in respective units for easy reference of syllabus.**
- ❖ **For every unit kindly use standard textbook for Preparation, Revise Previous question Paper & kindly be updated with the recent trends relates to the syllabus. For Example - Demonetisation, GST, Amendment of acts, Government Initiates etc.**



UNIT – 1: BUSINESS ENVIRONMENT

- ✓ Meaning and Elements of Business Environment
- ✓ Economic Environment, Economic Policies, Economic Planning
- ✓ Legal Environment of Business in India, Competition Policy, Consumer Protection, Environment Protection
- ✓ Policy Environment: Liberalisation, Privatisation and Globalisation, Second Generation Reforms, Industrial Policy and Implementation, Industrial Growth and Structural Change

BUSINESS ENVIRONMENT

Business environment refers to forces and institutions outside the firm with which its members must deal to achieve the organisational purposes. Here

- Forces = economical, social, political, technological etc
- Institutions = suppliers, customers, competitors etc

It includes all those constraints and forces external to a business within which it operates. therefore,

- The firm must be aware of these external forces and institutions and
- The firm must be nagged keeping in mind these forces and institutions so that the organisational objectives are achieved. .

Features of Business Environment

1. Totality of external forces: Business environment is the sum total of all the forces/factors external to a business firm.
2. Specific and general forces: Business environment includes both specific and general forces. Specific forces include investors, competitors, customers etc. who influence business firm directly while general forces include social, political, economic, legal and technological conditions which affect a business firm indirectly.

3. Inter-relatedness: All the forces/factors of a business environment are closely interrelated. For example, increased awareness of health care has raised the demand for organic food and roasted snacks.

4. Dynamic: Business environment is dynamic in nature which keeps on changing with the change in technology, consumer's fashion and tastes etc.

5. Uncertainty: Business environment is uncertain as it is difficult to predict the future environmental changes and their impact with full accuracy.

6. Complexity: Business environment is complex which is easy to understand in parts separately but it is difficult to understand in totality.

7. Relativity: Business environment is a relative concept whose impact differs from country to country, region to region and firm to firm. For example, a shift of preference from soft drinks to juices will be welcomed as an opportunity by juice making companies while a threat to soft drink manufacturers.

Importance of Business Environment

1. Identification of opportunities to get first mover advantage: Understanding of business environment helps an organization in identifying advantageous opportunities and getting their benefits prior to competitors, thus reaping the benefits of being a pioneer.

2. Identification of threats: Correct knowledge of business environment helps an organization to identify those threats which may adversely affect its operations. For example, Bajaj Auto made considerable improvements in its two wheelers when Honda & other companies entered the auto industry.

3. Tapping useful resources: Business environment makes available various resources such as capital, labour, machines, raw material etc. to a business firm. In order to know the availability of resources and making them available on time at economical price, knowledge of business environment is necessary.

4. Coping with Rapid changes: Continuous study/scanning of business environment helps in knowing the changes which are taking place and thus they can be faced effectively.

5. Assistance in planning and policy formulation: Understanding and analysis of business environment helps an organization in planning & policy formulation. For example, ITC Hotels planned new hotels in India after observing boom in tourism sector.

Business Environment class 12 Notes Business Studies

Helps in Improving performance: Correct analysis and continuous monitoring of business environment helps an organization in improving its performance.

Economic Environment in India

As a part of economic reforms, the Government of India announced New Economic Policy in July 1991 for taking out the country out of economic difficulty and speeding up the development of the country.

Main features of NEP, 1991 are as follows:

1. Only six industries were kept under licensing scheme.
2. The role of public sector was limited only to four industries.
3. Disinvestment was carried out in many public sector enterprises.
4. Foreign capital/investment policy was liberalized and in many sectors 100% direct foreign investment was allowed.
5. Automatic permission was given for signing technology agreements with foreign companies.
6. Foreign investment promotion board (FIPB) was setup to promote & bring foreign investment in India.
7. Various benefits were offered to small scale industries.

The three main strategies adopted for the above may be defined as follows:

Liberalisation

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

- Abolishing industrial licensing requirement in most of the industries
- Freedom in deciding the scale of business activities
- Freedom in fixing prices of goods and services
- Simplifying the procedure for imports and exports
- Reduction in tax rates
- Simplified policies to attract foreign capital and technology to India

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



Privatisation

Privatization, which has become a universal trend, means transfer of ownership and/or management of an enterprise from the public sector to the private sector. It also means the withdrawal of the state from an industry or sector, partially or fully. Another dimension of privatization is opening up of an industry that has been reserved for the public sector to the private sector. Privatization is an inevitable historical reaction to the indiscriminate expansion of the state sector and the associated problems. Even in the 'communist' countries it became a vital measure of economic rejuvenation.

The objects are:

- To improve the performance of PSUs so as to lessen the financial burden on taxpayers

- To increase the size and dynamism of the private sector, distributing ownership more widely in the population

at large

- To encourage and to facilitate private sector investments, from both domestic and foreign sources
- To generate revenues for the state
- To reduce the administrative burden on the state
- Launching and sustaining the transformation of the economy from a command to a market model

The important routes of privatization are:

- Divestiture, or privatization of ownership, through the sales of equity
- Denationalization or re privatisation
- Contracting - under which government contracts out services to other organizations that produce and deliver them
- Franchising- authorizing the delivery of certain services in designated geographical areas- is common in

utilities and urban transport

- Government withdrawing from the provision of certain goods and services leaving then wholly or partly to

the private sector

- Privatization of management, using leases and management contracts



- Liquidation, which can be either formal or informal. Formal liquidation involves the closure of an enterprise and the sale of its assets. Under informal liquidation, a firm retains its legal status even though some or all of its operations may be suspended

The benefits of privatization are as follows:

- It reduces the fiscal burden of the state by relieving it of the losses of the SOEs and reducing the size of the bureaucracy
- Privatization of SOEs enables the government to mop up funds
- Privatization helps the state to trim the size of the administrative machinery
- It enables the government to concentrate more on the essential state

The functions of privatization are as follows:

- Privatization helps accelerate the pace of economic developments as it attracts more resources from the

private sector for development

- It may result in better management of the enterprises

- Privatization may also encourage entrepreneurship

- Privatization may increase the number of workers and common man who are shareholders. This could

make the enterprises subject to more public vigilance

Due to the policy reforms announced in 1991, the expansion of public sector has literally come to a halt and the private sector registered fast growth in the post liberalised period.

The issues of privatisation include:

- reduction in the number of industries reserved for the public and the introduction of selective competition in the reserved area



– disinvestment of shares of selected public sector industrial enterprises in order to raise resources and to

encourage wider participation of general public and workers in the ownership in business

– improvement in performance through an MOU system by which managements are to be granted greater

autonomy but held accountable for specified results

– In India, as a result of these steps, the post liberalisation phase has witnessed a massive expansion of the

private sector business in India

Globalisation

India's economic integration with the rest of the world was very limited because of the restrictive economic policies followed until 1991. Indian firms confined themselves, by and large, to the home market. Foreign investment by Indian firms was very insignificant. With the new economic policy ushered in 1991, there has, however, been change. Globalization has in fact become a buzzword with Indian firms now and many are expanding their overseas business by different strategies. Globalization may be defined as “the growing economic interdependence of countries worldwide through increasing volume and variety of cross border transactions in goods and services and of international capital flows, and also through the more rapid and widespread diffusion of technology”.

Globalization may be considered at two levels viz. at the macro level (i.e., globalization of the world economy) and at the micro level (i.e., globalization of the business and the firm).

Globalization of the world economy is achieved, quite obviously, by globalizing the national economies. Globalization of the economies and globalization of business are very much interdependent.

Reasons for Globalisation

– The rapid shrinking of time and distance across the globe thanks to faster communication, speedier

transportation, growing financial flows and rapid technological changes

– The domestic markets are no longer adequate rich. It is necessary to search of international markets and to set up overseas production facilities

– Companies may choose for going international to find political stability, which is relatively good in other countries

– To get technology and managerial know-how

– Companies often set up overseas plants to reduce high transportation costs

– Some companies set up plants overseas so as to be close to their raw materials supply and to the markets

for their finished products

– Other developments also contribute to the increasing international of business.

– The US, Canada and Mexico have signed the North American Free Trade agreement (NAFTA), which will remove all barriers to trade among these countries

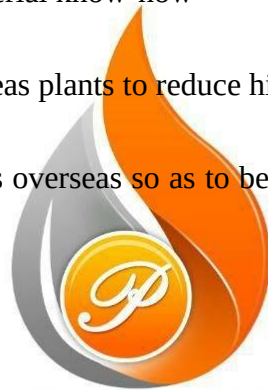
– The creation of the World Trade Organization (WTO) is stimulating increased cross-border trade

The following are the features of the current phase of globalization:

New Markets

– Growing global markets in services – banking, insurance, transport.

– New financial markets - deregulated, globally linked, working around the clock, with action at a distance in



real time, with new instruments such as derivatives.

- Deregulation of anti - trust laws and proliferation of mergers and acquisitions.
- Global consumer markets with global brands

New Rules and Norms

- Market economic policies spreading around the world, with greater privatization and liberalization than in

earlier decades

- Widespread adoption of democracy as the choice of political regime
- Human rights conventions and instruments building up in both coverage and number of signatories – and

growing awareness among people around the world

- Consensus goals and action agenda for development
- Conventions and agreements on the global environment – biodiversity, ozone layer, disposal of hazardous wastes, desertification, climate change

- Multilateral agreements in trade, taking on such new agendas as environmental and social conditions

- New multilateral agreements- for services, intellectual property, communications – more binding on national

governments than any previous agreements

- The multilateral agreements on investment under debate



DIMENSIONS/COMPONENTS OF BUSINESS ENVIRONMENT

1. Economic Environment: It has immediate and direct economic impact on a business. Rate of interest, inflation rate, change in the income of people, monetary policy, price level etc. are some economic factors which could affect business firms. Economic environment may offer opportunities to a firm or it may put constraints.

2. Social Environment: It includes various social forces such as customs, beliefs, literacy rate, educational levels, lifestyle, values etc. Changes in social environment affect an organization in the long run. Example: Now a days people are paying more attention towards their health, as a result of which demand for mineral water, diet coke etc. has increased while demand of tobacco, fatty food products has decreased.

3. Technological Environment: It provides new and advance ways/techniques of production. A businessman must closely monitor the technological changes taking place in the industry as it helps in facing competition and improving quality of the product. For Example, Digital watches in place of traditional watches, artificial fabrics in place of traditional cotton and silk fabrics, booking of railway tickets on internet etc.

4. Political Environment: Changes in political situation also affect business organizations. Political stability builds confidence among business community while political instability and bad law & order situation may bring uncertainty in business activities. Ideology of the political party, attitude of government towards business, type of government-single party or coalition government affects the business Example: Bangalore and Hyderabad have become the most popular locations for IT due to supportive political climate.

5. Legal Environment: It constitutes the laws and legislations passed by the Government, administrative orders, court judgements, decisions of various commissions and agencies. Businessmen have to act according to various legislations and their knowledge is very necessary. Example: Advertisement of Alcoholic products is prohibited and it is compulsory to give statutory warning on advertisement of cigarettes.

MAJOR STEPS IN ECONOMIC FORMS

1. New Industrial Policy – Under this the industries have been freed to a large extend from licences and other controls. Efforts have been made to encourage foreign investment.

2. New Trade Policy – The Foreign trade has been freed from the unnecessary control. The age old restrictions have been eliminated.

3. Fiscal Reforms. The greatest problem confronting the Indian Govt. is excessive fiscal deficit.

(a) Fiscal Deficit – It means country is spending more than its income

(b) Gross Domestic Product (GDP) – It is the sum total of the financial value of all goods & services produced in a year in a country.

4. Monetary Reform – It is a sort of control policy through which the central bank controls the supply of money with a view to achieving objectives of general economic policy.

5. Capital Market Reforms- The Govt. has taken the following steps for the development of this market:

(1) SEBI has been established.

(2) The restriction in respect of interest on debentures has been lifted.

(3) Private Sector has been permitted to establish Mutual Fund.

6. Dismantling Price control- The govt. has taken steps to remove price control in many products especially in fertilizers, iron and steel, petro products. Restrictions on the import of these things have also been removed.



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IMPACT OF GOVERNMENT POLICY CHANGES ON BUSINESS AND INDUSTRY

1. Increasing Competition: De-licencing and entry of foreign firms Indian market is increased the level of competition for Indian firms.

2. More Demanding Customers: Now customers are more aware and they keep maximum information of the market as the result of which now market is customer/buyer oriented, Now, products are produced keeping in mind the demands of the customers.

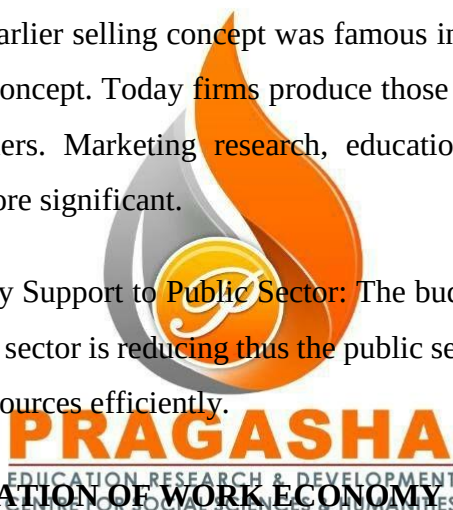
3. Rapid Changing Technological Environment: Rapid Technological advancement has changed/improved the production process as a result of which maximum production is possible at minimum cost but it leads to tough challenges in front of small firms.

4. Necessity for Change- After New Industrial. Policy the market forces (demand & supply) are changing at a very fast rate. Change in the various components of business environment has made it necessary for the business firms to modify their policies & operations from time to time.

5. Need for Developing Human Resources: The changing market conditions of today requires people with higher competence and greater commitment, hence there is a need for developing human resources which could increase their effectiveness and efficiency.

6. Market Orientation: Earlier selling concept was famous in the market now its place is taken by the marketing concept. Today firms produce those goods & services which are required by the customers. Marketing research, educational advertising, after sales services have become more significant.

7. Reduction in budgetary Support to Public Sector: The budgetary support given by the government to the public sector is reducing thus the public sector has to survive and grow by utilising their own resources efficiently.



TRANSNATIONALIZATION OF WORK ECONOMY

Regional Economic Grouping The post-second world war period has seen a growing interest in integrating national economies at regional levels, though the efforts have often floundered due to political difference and unforeseen economic hurdles. The motivation for regional economic integration arises out of the realization of the limitations imposed by national frontiers and the expected benefits of a wider market, consisting of several national economies, in terms of increased trade, investment and economic efficiency.

Forms of Economic Groupings Forms of economic groupings are diverse, involving difference levels of economic integration. Economic literature generally envisages four types of economic groups:

- (a) Free Trade Area
- (b) Customs Union

- (c) Common Market
- (d) Economic Union.

GLOBAL ENTRY STRATEGIES

Strategic decisions become increasingly complex, intricate and multi-dimensional, when an organization goes global. A manager is faced with trade-off decisions taking into account the multiple products, country environments, resource options, corporate and subsidiary capabilities and strategic options. The global increase of international business certainly affects the world economy and economic order. As the business goes global, its right arm is marketing. Global business operations warrant competent, and aggressive strategic management in all aspects-finance, production, personnel but the key factors that determine its success or failure are market skills, acumen and know how. When a firm wants to go global, it has to make at least five strategic decisions in so far as marketing the goods in the global market:

1. The Strategic Marketing Decision. The moment the firm decides to go global, a new marketing strategy is to be developed to be used for home and foreign markets for its activities. This decision is to be taken only after in-depth study of opportunities and threats taking a long-term view. Success in global market is not easy that calls for good deal of investment in terms of time, treasure and talent. It needs hard and smart work, courage and patience.



2. The Strategic Market Selection Decision. With the resource constraints, it is very criminal decision where resources are allocated to encash on the opportunities open. A firm has to decide as to the alternatives of which one is selected namely, undifferentiated, differentiated and concentrated. For beginners, it pays to go in for concentrated market. As a part of its selection of target market depends on – size of the market – growth potential - logistics - distance - nature and degree of competition – the distribution system.

3. The Strategic Market Entry Decision. This is equally significant decision where the company can choose between or amongst seven options. What is the best for a firm that depends on the organisations strengths and weaknesses. These options are 1. Direct exporting, 2. Indirect exporting, 3. Franchising, 4. Licencing, 5. Joint ventures, 6. Foreign subsidiaries and 7. Strategic alliances. Each has its own merits and demerits.

4. The Strategic Marketing Mix Decision. The firm has to plan and execute a programme or marketing mix suitable to the marketing environment prevailing in that or those foreign markets. The basic question is to what extent the existing product, promotion, pricing and distribution variables in the marketing mix are to be changed to match it to a given country's environment.

5. The Strategic Marketing Organization Decision. The focal challenge facing any export marketing operations is to organise its resources and corporate units and schemes to achieve its objectives of sales and profits to its best. The way the firm is organised greatly and deeply influences its managerial style and operation of global business. Organisation is a tool to conduct its global business as to plan, coordinate and control.

The organizational options are six: 1. Functional 2. Product 3. Customer 4. Area 5. Channel and 6. Matrix. What for is best, it depends again on unique features of the organization or the conditions in which it is working. Based on these, the organization structure is to be selected.

R.T.P.

According to M.R.T.P Act [Section 2(0)], – A restrictive trade practice means, a trade practice which has or may have, the effect of preventing, distorting or restricting competition in any manner and in particular, (i) which tends to disrupt the flow of capital or resources into the stream of production or (ii) which tends to bring about the manipulation of prices, or condition of delivery, or to affect the flow of supplies in the market relating to goods or services in such manner as to impose on the consumers unjustified costs or restrictions.

The following are the R.T.Ps as described by Section 33 (1) of the M.R.T.P Act:

- Refusal to deal with persons or classes of persons - Any agreement which restricts or is likely to restrict by any methods, the persons or classes of persons to whom goods are sold or from whom goods are bought.
- Tie-in sales or full-line forcing - Any agreement requiring the purchaser of goods, as a condition of such purchase, to purchase some other goods.

- Exclusive dealing agreement - Any agreement restricting in any manner the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any other goods.
- Collective price fixation and tendering - Any agreement to purchase or sell goods or take out tenders for the sale or purchase of goods only at prices or terms and conditions agreed upon between the sellers or purchasers.
- Discriminatory dealings - Any agreement to grant or allow concessions or benefits including allowances, discounts, rebate or credit, in connection with or by reason of dealings.
- Re-sale price maintenance - Any agreement to sell goods on condition that the prices to be charged on re-sale by the purchaser shall be the prices stipulated by the seller unless it is clearly stated that prices lower than those prices may be charged.
- Restriction on output or supply of goods - Exclusive distributorship, territorial restriction and market-sharing. I Control of manufacturing process.
- Boycott - Any agreement for the exclusion from any trade association or any person carrying on or intending to carry on, in good faith, the trade in relation to which the trade association is formed. I Price control arrangements.
- Governmental recognition of practice as restrictive.
- Residual restrictive trade practice - Any agreement to enforce the carrying out of any such agreement as is referred to in the foregoing classes.

Under the Act, restrictive agreement must be submitted to the Registrar for registration within 60 days from the date of entering these agreements. Here the onus is on the company or the undertaking.

Regulation of R.T.Ps

The M.R.T.P Commission is empowered under section 37 of the Act, to conduct an enquiry into any R.T.P. If after the enquiry, the Commission is of the opinion that the practice is really restrictive and is prejudicial to public interest, it (the Commission) may, by order, direct that: I the practice shall be discontinued or shall not be repeated. This is called the cease-and-desist order and I the agreement shall be void and shall stand modified in such a manner as may be specified in the order.

W.T.O

G.A.T.T organization was formed in 1948. And as a result of Uruguay Round the G.A.T.T was transformed into World Trade Organization with effect from January, 1995. After about five decades, the original proposal of an International Trade Organization has taken shape as the W.T.O. W.T.O will serve as a single institutional framework encompassing G.A.T.T and all the results of the U.R (Uruguay Round). It will be directed by a Ministerial Conference that will meet at least once every two years and its regular business will be overseen by a General Council. The W.T.O has the following functions:

1. The W.T.O shall facilitate the implementation, administration and operation and further the objectives of the Multilateral Trade Agreements and shall also provide the framework for the implementation, administration and operation of Plurilateral Trade Agreements.
2. The W.T.O shall provide the forum for negotiations among its members concerning their multilateral trade relations in matters dealt with under the Agreements.
3. The W.T.O shall administer the 'Understanding on Rules and Procedures Governing the Settlement of Disputes'.
4. The W.T.O shall administer the 'Trade Review Mechanism'.
5. With a view to achieving greater coherence in global economic policy making, the W.T.O shall co-operate, as appropriate, with the I.M.F and I.B.R.D and its affiliated agencies.

The W.T.O is a more powerful body with enlarged functions than the G.A.T.T and is envisaged to play a major role in the world economic affairs. To become a member of the W.T.O, a country must completely accept the result of the Uruguay Round.

Economic Policies and the Planning Process of India

On 15th August 1947 when India became independent politically, the country stood at the threshold of a new era.

The country at this stage was under-developed and its people were on the brink of poverty. Its vast resources, agriculture and minerals were unexploited due to lack of proper direction.

Planning offered the only way to achieve a rapid and balanced growth keeping the national priorities in mind. The state was now expected to play an active part in economic and social development. The success of such planned development in both agrarian and industrial sector in the USSR also played a part in popularizing the concept of planned development.

After the adoption of a new constitution, the government of India set up the Planning Commission in March 1950 to assess the country's material, capital and human resources and to formulate a plan for the most effective and balanced utilization.

The first Prime Minister, Pt. Jawaharlal Nehru was also its first chairman. The Finance Minister and the Minister for planning were its essential members amongst other ministers in different capacities linked to economic development.

Some of the objectives outlined in these plans were maximization of national income, rapid industrialization, providing full employment and most importantly achieving self-sufficiency. The central purpose identified with the process of development was to raise the standard of living and opening out more opportunities to people.



Planning in India needed proper channelling of resources into different developmental activities in accordance with accepted national priorities. While short-term developmental objectives have varied from plan to plan, the planning process was in some ways inspired by certain long-term goals.

These are:

(a) High growth rate with a view to improve the standard of living. Due to the oppressive policies of the British, the country in the colonial period witnessed a retarded development. The standard of living of the people was very low. The general objectives of all the Five year plans have been to raise the standard of living and achieve a much higher growth rate of national income.

(b) Achieving social justice. As per the Directive Principles of State Policy laid down in the Constitution, achievement of justice- social, economic and political were proclaimed as a national commitment. The Five Year Plans being an inherent part of state policy, social justice figured as the most important objective in them.

Its purview covered the achievement of economic and social equality and regional balance in development and avoidance of concentration of economic power. Special care for the backward classes of the population is one of the targets for attaining social justice.

(c) Economic self-reliance. Political independence is never complete without economic independence. Self-reliance in this regard came as a natural objective of the successive Five Year Plans.

The emphasis was on achieving financial self-reliance. Its essence lay in the fact that the economy should be able to finance its continued growth at a satisfactory rate largely from domestic resources. Foreign and external help should be kept at minimum level.

However, a major policy change occurred in this regard from 1991 when the Government at the Center liberalized the economy and went all the way to attract foreign investments in order to modernize the economy faster.

The strategy for development included a comprehensive planning for all round development; a mixed economy approach to keep up the socialistic pattern of development; achieve a balanced development that would develop both agriculture and industry; provide maximum employment; cater to the development of backward areas; to uplift the backward classes and achieve overall social welfare.

First Five-Year Plan (1951-52 to 1955-56):

The first five-year plan had a two-fold objective:

1. To correct the disequilibrium in the economy caused by the Second World War and the partition of the country.

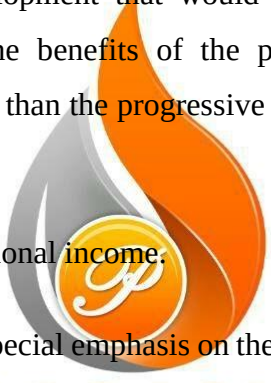
2. To initiate simultaneously a process of all round development which would ensure a rise in national income and a steady improvement in the living standards of the people.

The plan accorded the highest priority to agriculture, including irrigation and power projects. The plan also aimed at increasing the rate of investment from 5% to 7% of the national income. The growth rate achieved in this plan was 3.6%.

Second Five-Year Plan (1956-57 to 1960-61):

In December 1954, the Parliament declared the objective of the Second Plan to achieve the Socialistic Pattern of Society. The basic aim under this was to attain greater equality of income and wealth and not private profit.

It promoted a pattern of development that would lead to the establishment of a socialistic society in India. The benefits of the plan were directed towards the betterment of the less privileged than the progressive sections. The main objectives of the second plan were:

- 
- a. An increase of 25% in the national income.
 - b. Rapid industrialization with special emphasis on the development of basic and heavy industries.
 - c. Large expansion of employment opportunities.
 - d. Reduction of the inequalities in income and wealth and a more even distribution of economic power.

The Plan aimed at increasing the rate of investment from 7% to 11 % of the national income by 1960-61. This plan increased the scope of industrialization by increasing the production of iron and steel, heavy chemicals, development of heavy engineering and machine building industries.

For the first time long-term economic policy was formulated and loans were taken from foreign countries. The growth rate achieved was 4%. Rapid industrialization and diversification of the economy were the main course of development. The development

of basic industries and allocation of resources among different sectors were also taken carefully.

Third Five-Year Plan (1961-62 to 1965-66):

The third Five Year Plan aimed at securing a marked advance towards self-sustaining growth. Its objectives were:

(a) Increase in the national income of over 5% per annum and at the same time ensure a pattern of investment that would sustain this rate of growth during subsequent plan periods.

(b) Achieve self-sufficiency in food grains and increase agricultural production to meet the requirements of the industry and exports.

(c) Expand the basic industries like steel, chemicals, fuel and power and to establish machine building ability so that requirement of further industrialization could be met within a period of ten years and that too from the country's own resources.

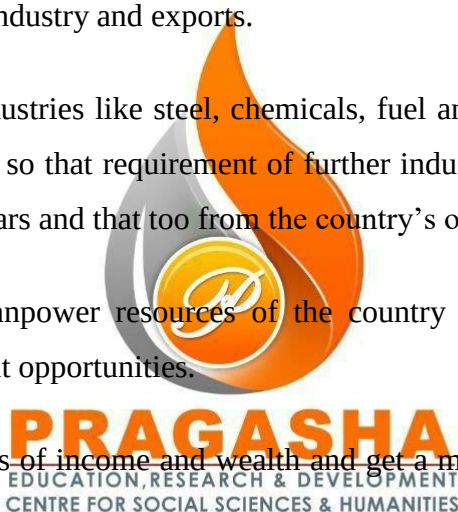
(d) Utilize fully the manpower resources of the country and ensure a substantial expansion in employment opportunities.

(e) Bring down disparities of income and wealth and get a more equitable distribution of economic power.

The national income in this plan was to increase by about 30% by 1965-66 and per capita income by about 17% during the period. The growth rate stipulated at 2.2%. The Programmes of the second plan were carried over in the third plan too. The development of basic industries remained a fundamental concern to growth.

Annual Plans (1967, 1968, 1969):

The situation created by the Indo-Pak conflict, two successive years of severe drought, 1965-66 and 1966-67, devaluation of the currency in 1966, general rise in prices and erosion of resources available for plan purpose delayed the finalization of the fourth five year plan.



Instead three annual plans were formulated within the framework of the draft outline of the fourth plan. The main aim of this plan was to restore normalcy in the economy. The emphasis of these plans was to adopt irrigation projects along with the use of high yielding variety crops in the agricultural sector. In the industrial sector the stress was on the utilization of the existing capacity and on consumer goods industry.

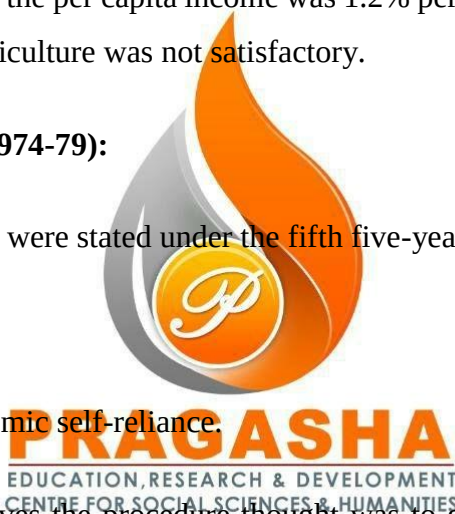
Fourth Five-Year Plan (1969-70 to 1973-74):

The Fourth plan aimed at raising the standard of living of the people through programmes that would promote social justice and equality at the same time. The concentration of the plan was the welfare of the weaker sections of the society especially through employment and education. The rate of growth in national income was 3.3% per annum and the per capita income was 1.2% per annum. The performance in industry as well as agriculture was not satisfactory.

Fifth Five-Year Plan (1974-79):

The following objectives were stated under the fifth five-year plan:

- a. Removal of poverty.
- b. Achievement of economic self-reliance.



To achieve these objectives the procedure thought was to get a 5.5% overall rate of growth; expansion of productive employment; extended programmes of social welfare; emphasis on agriculture and basic industry with special attention to production for mass consumption; export promotion and substitution of imports.

The Fifth plan that was to be completed in March 1979 was completed earlier; by March 1978. This was the golden period for rural development as the largest funds were diversified for rural development. The rate of growth achieved was 5.2%.

Sixth Five-Year Plan (1980-85):

This plan accelerated the work for the removal of poverty, generation of gainful employment and technological and economic self-reliance. The plan targeted a growth

rate of 5.2% and achieved it. It was successful in achieving the required industrial development and agricultural growth. It also achieved aims of social justice.

The plan undertook the development of underdeveloped areas of the country. It also concentrated on the refinement of technology. It was the first perspective plan of the country slated for a long term of fifteen years. It also saw a rapid growth in the service sector. About 94% of the cost of investments was met from the domestic resources projecting the self-reliance of the country.

Seventh Five-Year Plan (1985-90):

The sixth five-year plan provided the background for the next plan. The guiding principles of the plan continued to be growth, equity and social justice, self-reliance, improved efficiency and productivity. The policies to accelerate growth in food grains production, increase employment opportunities and raise productivity were pursued in this plan.

The rate of growth of 5.6% was kept for this plan. The strategy in the seventh plan to generate productive employment was to increase cropping intensities and extension of agriculture through use of new technologies. Emphasis was also given on various rural schemes for development.

Eighth Five-Year Plan (1992-97):

The Eighth plan had the following objectives:

- a. Generating adequate employment to achieve near full employment level by the turn of the century.
- b. Containing population growth through active scheme of incentives.
- c. Eradication of illiteracy in the age group of 15 to 35 years.
- d. Provision for health and availability of safe drinking water especially in villages.
- e. Self-sufficiency in food and generation of agricultural surplus.

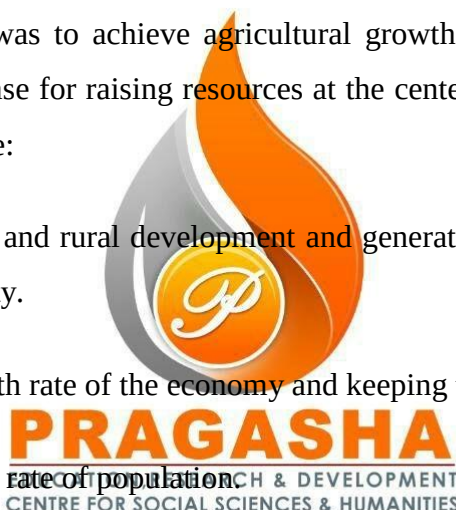
f. Strengthening the infrastructure in order to support growth process on a sustained basis.

The strategy for achieving the above mentioned goals was to be a mixture of new investments and correction of imbalances in different sectors and increasing investment efficiency. This plan also aimed at a 5.6% growth per annum. Much of the investments was to be met by capital inflow from abroad in the form of loans.

Ninth Five-Year Plan (1997-2002):

The Ninth plan proposed to achieve a 7% growth rate during the plan period. It introduced fiscal discipline and aimed to control rise in prices through controlling money supply. It aimed at resource mobilization and attract foreign direct investment. The thrust of the plan was to achieve agricultural growth. The proposition was to broaden the direct tax base for raising resources at the center. Some of the objectives outlined in this plan were:

- a. Priority to agriculture and rural development and generate productive employment and eradication of poverty.
- b. Accelerating the growth rate of the economy and keeping the prices stable.
- c. Containing the growth rate of population.
- d. Promoting and developing people's participatory institutions like the Panchayati Raj and Cooperatives.
- e. Strengthening efforts of building self-reliance.



Agrarian Reforms:

Independent India inherited a predominantly agrarian economy from the colonial period. At present 40% of the national income comes from agriculture and allied activities. It has remained the mainstay of the Indian economy and has provided a livelihood to a greater part of the population.

Agriculture occupies an important position with regard to industrial development. A steady and sustained agricultural base ensures a self sufficient and adequate industrialization too. Agriculture provides raw materials to industries. The growth of major industries as cotton, textile, jute, sugar etc. is affected by fluctuations in agriculture. It provides food grains to the industrial population by creating a marketable surplus.

Some of the distinguished features of Indian agriculture are as follows:

a. In spite of being the principal industry, agriculture continues to be backward in character. The yield per hectare of land of all the principal crops produced in India is low. Productivity per worker is equally low.

b. Agriculture in India is largely carried on the basis of subsistence farming. The cultivator produces mainly for himself and his family's consumption. Thus generation of marketable surplus always remained as the focus of the planning for agriculture.

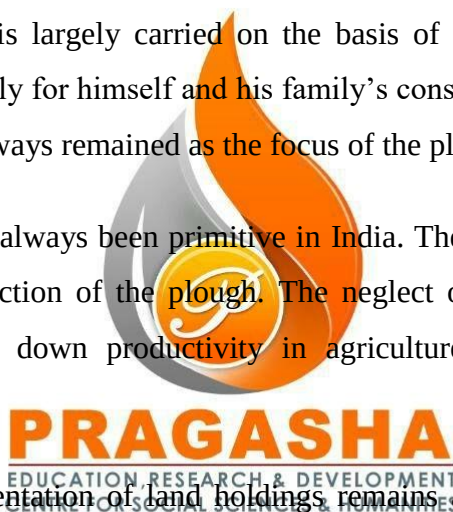
Mode of cultivation has always been primitive in India. The cultivator uses the same old techniques of production of the plough. The neglect of modern techniques for production also slowed down productivity in agriculture and it remains labour intensive.

Sub-division and fragmentation of land holdings remains a perpetual problem with Indian agriculture. The larger family concept leads to division of family land into several divisions. These lands besides being small and unproductive fail to generate adequate surplus also.

Measures to improve agricultural production and productivity have come to be termed as agrarian reforms. Broadly two sets of measures are adopted. They are linked intricately with land ownership, tenancy and distribution measures.

i. Institutional measures

ii. Technological measures



Institutional Measures:

With reference to land reforms, it was necessary to have a land ownership pattern that is socially just and economically viable. The measures adopted for land reform were:

a. Abolition of intermediaries:

At the time of independence, three different types of land tenure system were prevailing in India – Zamindari, Mahalwari and Ryotwari. After independence the first important step that the government taken up was the abolition of intermediaries. The state Governments enacted legislations to take over the intermediary rights from zamindars. The abolition of intermediaries was effected by March 1968 and fully implemented in several states. It is said that about 30 million tenants benefited from the zamindari abolition.

Tenancy reforms in India had been conferred the benefit of security of land tenure by preventing large-scale eviction of tenants. Resumption of land by the owner for personal cultivation only, assuring a prescribed minimum area of land to the tenants has been provided for in the legislations.

Payment of rent by the tenants to the landlord had now been regulated. The rent varied from $\frac{1}{3}^{\text{th}}$ to $\frac{1}{5}^{\text{th}}$ of the gross produce. Provisions have been made in the tenancy legislation for conferment of ownership rights to tenants.

b. Ceiling on Land Holdings:

Land holdings were limited on a minimum as well as a maximum ceiling. The maximum limit has been fixed to do social justice. The minimum has been fixed to prevent uneconomic unit of cultivation. The ceiling on land has been enacted in most of the states in the post independence period.

Those possessing land beyond the maximum limit would have to surrender the surplus land to the state. People with uneconomic units, evicted tenants and landless workers are usually distributed these surplus lands. Through this ceiling of land the Government intends to minimize the concentration of economic power and wealth. It would ensure

fuller utilization of workforce in agriculture and shall also enhance the social status of the rural poor.

c. Consolidation of Land Holdings:

In order to solve the problem of fragmented holdings, consolidation is one of the best measures. It means pooling together in one compact block all the plots of land of a farmer that are scattered all over the village. Not only does the cultivator get a compact portion of land but the total land or unit also remains the same.

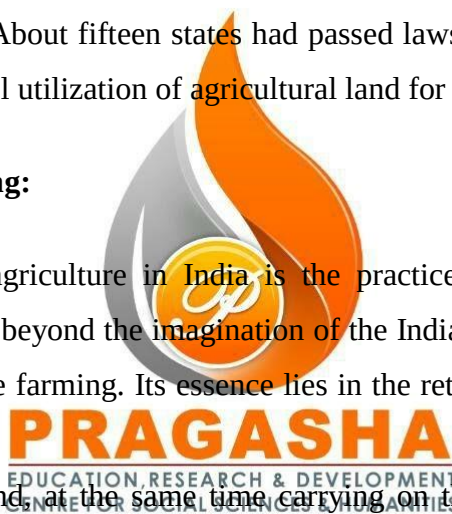
This kind of operation not only makes agricultural production economic but also reduces the area of wasteland. By 1985 about 51.8 million hectare of land had been consolidated. It has led to more productivity and increase in the cultivable area by removal of boundaries. About fifteen states had passed laws on consolidation of land and this has led to the full utilization of agricultural land for cultivation.

(d) Cooperative Farming:

The main problem of agriculture in India is the practice of subsistence farming. Economic farming is far beyond the imagination of the Indian cultivator. A remedy in this regard is cooperative farming. Its essence lies in the retention of the rights of the individual

cultivator in his own land, at the same time carrying on the agricultural operations jointly. The main features of this kind of method are the following:

- i. Land formed into a single unit.
- ii. Land proprietorship remains with the individual cultivator.
- iii. Management of land carried on jointly.
- iv. Members are paid for their work.
- v. Net profits are distributed amongst members but some of it is held back for building up reserves and resources.



In return the state offers its assistance to such a society by advancing loans for purchase of seeds, supply of manures and other necessary implements for cultivation. This has solved the problems of uneconomic farming to a great extent.

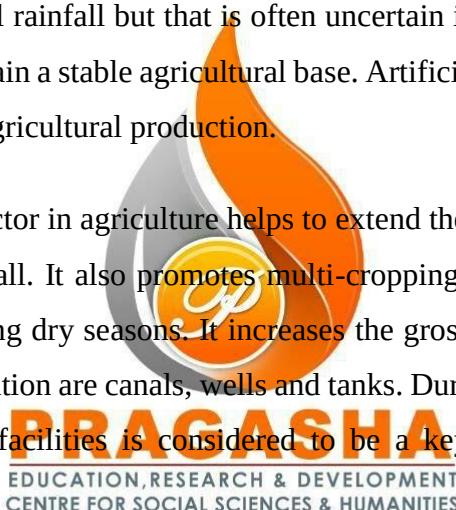
Technological Measures:

The initial plans did not provide any facility for improvement in farming techniques. Agricultural efficiency depends to a great extent on the input and method of cultivation practiced. The various branches of technological measures are:

a. Irrigation:

Adequate supply of water is the primary necessity for good agriculture. Geographically India receives substantial rainfall but that is often uncertain in volume, time and place and is not enough to sustain a stable agricultural base. Artificial irrigation thus becomes a necessity to improve agricultural production.

Irrigation being a key factor in agriculture helps to extend the net sown area in regions that receive scanty rainfall. It also promotes multi-cropping by making it possible to raise a second crop during dry seasons. It increases the gross cropped area. The main sources of artificial irrigation are canals, wells and tanks. During the seventh plan rapid expansion in irrigation facilities is considered to be a key element in agricultural procedures.



b. Fertilizers and Manures.

In order to increase agricultural productivity, fertilizers and manures played an important role. Previously animal dung, compost and bones and other organic manures were used to restore the nutrients of the soil. The land was also left fallow to rebuild its nutrients. In recent years the uses of chemical fertilizers have greatly added to agricultural productivity.

The consumption of fertilizers increased from 69,000 tonnes of nutrients in the first plan to 9.6 million tonnes by the end of the sixth plan. This varied use of improved fertilizers has increased the crop area and led to better productivity. To increase consumption of fertilizer the sixth plan aimed at ensuring equitable and efficient

fertilizer distribution and to see that its benefits are received by all sectors of the farming community.

To ensure the fuller benefits of such manures adequate measures were taken to protect the crops from rodents and pests. Plant protection measures were also an important component of increasing crop yield.

Improved Seeds:

A great amount of improvement can be brought about by the use of better seeds in agriculture. The yield from better seeds is larger and the crop too sells for a better price.

To promote the use of better seeds the Government has set up the National Seeds Corporation. State Farms Corporations have also been established in 1969 to encourage the production and distribution of certified seeds.

Thirteen State Seeds Corporations have also been established to supply improved seeds to farmers. Improved varieties of seed have been discovered for practically all cereal crops and oil seeds, pulses, jute, cotton and sugarcane have been planted in high yielding varieties of seeds. The spread of high yielding technology based on fertilizer and irrigation responsive high yielding varieties of crops since 1960s commonly known as Green Revolution has greatly added to the output of wheat and rice.

The high yielding variety programme started as a part of the third plan and the annual plans had a lot of provisions for the improvement in agricultural productivity. The main emphasis under the HYVP was on improved variety of seeds for raising the yield per hectare of land. Total area under HYVP was 54.5 million hectare in 1984-85.

These now form a major strategy of agricultural development in India. The introduction of this programme had led to self-sufficiency in food production in India. At a point it was even proposed that such high yielding variety of seeds would be distributed free of cost to cultivators to improve the yield per hectare of land.



(d) Credit and Finance Facilities:

The average farmer in India is very poor. He is unable to improve cultivation on his own. Traditionally his borrowing agencies have been the moneylenders who extorted the maximum out of him to fill their pockets. But in the post independence era, agricultural production came under the supervision of the government and all intermediaries were removed.

Besides other assistance in agricultural operations, the average farmer was also advanced credit facilities to improve productivity. The farmer needed financial assistance to buy goods quality seeds, implements and agricultural machinery to carry on operations. The scheme of providing loans was made easy to facilitate the farmer to repay them.

Non- traditionally, cooperatives, credit societies and land development banks provide short, medium and long-term credit to the cultivators. These agencies provide loans at reasonable rate of interest.

The various agencies providing loans to farmers are the Agricultural Credit Societies. One of the earliest of such agencies are the Primary Agricultural Credit Societies (PACS) while the Land Development Banks were a source of long term loans to the farmers. The former were tied to the Central Cooperative Banks (CCB) and the latter to the State Cooperative Banks (SCB).

However the essence of cooperative structures was missing in these agencies. They were not self-sufficient and were dependent on each other for generating credit.

Gradually the Commercial Banks were realized as another source for rural credit. These Commercial Banks too provided loans on direct basis for short as well as long term. They provided loans for distributing fertilizers and other agricultural inputs.

A third field agency called the Regional Rural Banks (RRB) was introduced in October in 1975. Their role was to provide credit for agricultural and rural development where the other two agencies were weak. The RRBs were intended to be banks that the average man could afford. Scheduled banks usually public sector banks sponsor the RRBs.

The Reserve Bank of India and the State banks help the farmers only through these networks of cooperative institutions.

The National Bank for Agriculture and Rural Development (NABARD) has been the apex refinancing institution for agriculture and rural credit. The NABARD functions as a financing institution to the various SCBs and RRBs. Prior to the NABARD these refinancing functions were performed by the RBI.

Thus the role of credit institutions in advancing loans crucial to development of agriculture has been immense. It is primarily because of these facilities that agricultural operations have been launched in a big way by various categories of Indian cultivators.

Competition Law in India - An Overview

Competition is a process of economic rivalry between market players to attract customers. Competition also refers to a situation in a business environment where businesses independently strive for the patronage of customers in order to achieve their business objective. Free and fair competition is one of the pillars of an efficient business environment.

In the recent years the Indian economy has been one of the best performers and is on high growth path. Infusion of greater degree of competition can play a catalytic role in unlocking the fuller growth potential in many critical areas of the economy. In the interest of consumers, and the economy as whole, it is necessary to promote an environment that facilitates fair competition outcomes in the market, restrain anti-competitive behavior and discourage market players from adopting unfair trade practices. Therefore, competition has become a driving force in the global economy.

Evolution and Development of Competition Law in India

In India the first competition law was enacted in 1969 i.e. Monopolies and Restrictive Trade Practices Act, 1969 [**MRTP Act, 1969**]. The Monopolies and Restrictive Trade Practices Bill was introduced in the Parliament in the year 1967 and the same was referred to the Joint Select Committee. The MRTP Act, 1969 came into force, with effect from, 1 June, 1970.

The enactment of MRTP Act, 1969 was based on the socio – economic philosophy enshrined in the Directive Principles of State Policy contained in the Constitution of India. The MRTP Act, 1969 underwent amendments in the 1974, 1980, 1982, 1984, 1986, 1988 and 1991. The amendments introduced in the year 1982 and 1984 were based on the recommendations of the Sachar Committee, which was constituted by the Govt. of India under the Chairmanship of Justice Rajinder Sachar in the year 1977.

The Sachar Committee pointed out that advertisements and sales promotions having become well established modes of modern business techniques, representations through such advertisements to the consumer should not become deceptive. The Committee also noted that fictitious bargain was another common form of deception and many devices were used to lure buyers into believing that they were getting something for nothing or at a nominal value for their money. The Committee recommended that an obligation is to be cast on the seller to speak the truth when he advertises and also to avoid half truth, the purpose being preventing false or misleading advertisements.

The Finance Minister in its budget speech in February, 1999 said –

"The MRTP Act has become obsolete in certain areas in the light of international economic developments relating to competition laws. We need to shift our focus from curbing monopolies to promoting competition. The Government has decided to appoint a committee to examine this range of issues and propose a modern competition law suitable for our conditions."

In October 1999, the Government of India constituted a High Level Committee under the Chairmanship of Mr. SVS Raghavan [**'Raghavan Committee'**] to advise a modern competition law for the country in line with international developments and to suggest legislative framework, which may entail a new law or suitable amendments in the MRTP Act, 1969. The Raghavan Committee presented its report to the Government in May 2000.

On the basis of the recommendations of the Raghavan Committee, a draft competition law was prepared and presented in November 2000 to the Government and the

Competition Bill was introduced in the Parliament, which referred the Bill to its Standing Committee. After considering the recommendations of the Standing Committee, the Parliament passed December 2002 the Competition Act, 2002.

The Monopolies and Restrictive Trade Practices Act, 1969 [**MRTP Act**] repealed and was replaced by the Competition Act, 2002, with effect from 1 September, 2009.

The Competition Act, 2002 was enacted to provide for the establishment of a Commission to prevent practices having adverse effect on competition, and to promote and sustain competition in the business environment and to protect the interest of consumers and also to ensure freedom of trade carried on by other participants in markets in India and for matters connected therewith or incidental thereto. The Competition Act, 2002 came into existence in January, 2003 and the Competition Commission of India [**'CCI'**] was established on 14 October, 2003. CCI consists of a Chairperson and 6 Members appointed by the Central Government. CCI functions as market regulator for preventing and regulating anti – competitive practices in the country. A Competition Appellate Tribunal was also established, which is a quasi-judicial body established to hear and dispose of appeals against any direction issued, or decision made by the CCI.

The Act was subsequently amended by the Competition (Amendment) Act, 2007 and Competition (Amendment) Act, 2009. The provisions of the Competition Act relating to anti-competitive agreements and abuse of dominant position were notified on 20 May, 2009.

Introduction of the Act was a key step towards facing competition. The Competition Act, 2002 is not intended to prohibit competition in the market. The legislation prohibits anti-competitive agreements, abuse of dominant position and regulates mergers, amalgamations and acquisitions.

Elements of Competition Law

There are three major elements of a competition law; i) Anti – competitive agreements; ii) Abuse of dominance; and iii) Merger, amalgamations and acquisitions control.

Anti- Competitive Agreements

Anti-competitive agreements are those agreements that restrict competition. Section 3 of the Competition Act, 2002 prohibits any agreement with respect to production, supply, distribution, storage, and acquisition or control of goods or services which causes or is likely to cause an appreciable adverse effect on competition in India. The term 'Agreement' is broadly defined in section 2(b) of the Competition Act, 2002 and includes any arrangement or understanding or concerted action, whether or not it is formal, in writing or intended to be enforceable by legal proceedings. The agreements does not necessarily have to be a formal one and in writing or justifiable in a court of law and an informal agreement to fix prices will be hit by the provisions of the Competition Act, 2002.

Section 3(2) of the Competition Act, 2002 declares that any anti competitive agreement within the meaning of section 3(1) of the Competition Act, 2002 shall be void. The whole agreement is construed as void if it contains anti – competitive clauses having appreciable adverse effect on the competition. The term 'appreciable adverse effect on competition' used in section 3, is not defined in the Act. However, the Act specifies a number of factors which the Competition Commission of India must take into account while determining whether an agreement has an appreciable adverse effect on competition or not.

Agreement between rivals or competitors is termed as horizontal agreements. The most malicious form of an anti-competitive agreement is cartelization. When rivals or competitors agree to fix prices or share consumer or do both, the agreement termed as cartel. Besides horizontal agreements, there can be anti-competitive agreements between producers and suppliers or between producers and distributors. These are referred to as vertical agreements. Vertical agreements too can undermine competition in the market.

According to section 3(3) of the Act, the kind of agreements which would be considered to have an 'appreciable adverse effect on competition' would be those agreements which –

- Directly or indirectly determine sale or purchase prices;
- Limits or control production, supply, markets, technical developments, investments or provision of services;

- Share the market or source of production or provision of services by allocation of inter-alia geographical area of market, nature of goods or number of customers or any other similar way;
- Directly or indirectly result in bid rigging or collusive bidding.

The agreements falling in section 3(3) of the Act shall be judged by 'shall be presumed rule' and onus to prove otherwise lies on the defendant.

Section 3(4) provides that any agreement amongst enterprises or persons at different stages or levels of the production chain in different markets, in respect of production, supply, distribution, storage, sale or price of, or trade in goods or provision of services, including i) Tie-in agreement; ii) Exclusive supply agreement; iii) Exclusive distribution agreement; iv) Refusal to deal; v) Resale price maintenance, shall be presumed an anti-competitive agreement, if such agreements causes or is likely to cause an appreciable adverse effect on competition in India.

The agreements falling in section 3(4) of the Act shall be judged by 'rule of reason' and the onus lies on the prosecutor to prove its appreciable effect on competition in India.

The section 3(5) of the Act gives due recognition to the intellectual property rights, which provides that the prohibition against anti – competitive agreements shall not restrict the right of any person to restrain any infringement of, or to impose reasonable conditions as may be necessary for protecting, any rights under the Copyright Act, 1957, the Patents Act, 1970, the Trade Marks Act, 1999, the Geographical Indications of Goods (Registration and Protection) Act, 1999, the Designs Act, 2000 and the Semiconductor Integrated Circuits Layout-Design Act, 2000.

Further the Competition Act, 2002 does not restrict any person's right to export from India goods under an agreement which requires him to exclusively supply, distribute or control goods or provisions of services for fulfilling export contracts.

Thus any agreement for the purpose of restraining infringement of such Intellectual Property Rights or for imposing reasonable conditions for protecting such rights shall not be subject to the prohibition against anti-competitive agreements.

Abuse of Dominant Position

Section 4 of the Competition Act, 2002 expressly prohibits any enterprise or group from abusing its dominant position. The term 'Dominant Position' includes a position of strength, enjoyed by an enterprise or group, in relevant market, in India, which enables it to –

- a) Operate independently of competition forces prevailing in the relevant market; or
- b) Affect its competitors or consumers or the relevant market in its favour.

The terms 'Dominance' is also referred to as market power which is defined as the ability of the firm to raise prices or reduce output or does both independently of its rivals and consumers.

As per Section 2(r) of the Competition Act, 2002 'relevant market' means the market, which may be determined by the Competition Commission of India with reference to the relevant 'product market' or 'relevant geographical market' or with reference to both.

The Act requires that relevant product market is to be determined by considering; physical characteristics or end-use of goods; the price of goods or services; consumer preferences; exclusion of in-house production; the existence of specialized producers; and the classification of industrial products. Further the relevant geographical market is determined by considering; regulatory barriers; local specification requirements; national procurement policies; adequate distribution facilities; transport costs; language; consumer preferences; and need for secure or regular supplies or rapid after – sales services.

In short, there shall be an abuse of dominant position if an enterprise indulges into the below mentioned activities –

- Directly or indirectly imposing discriminatory conditions in the purchase or sale of goods or service, or setting prices in the purchase or sale (including predatory pricing) of goods or services;

- Limiting or restricting the production of goods or provision of services or market therefore; or limiting technical or scientific development relating to goods or services to the prejudice of customers;
- Indulging in practice or practices resulting in the denial of market access;
- Making conclusion of contracts subject to acceptance by other parties of supplementary obligations, which has no connection with the subject of such contract;
- Utilization of the dominant position in one relevant market to enter into, or protect, another relevant market.

Section 19(4) of the Act empowers the Competition Commission of India to determine whether any enterprise or group enjoys a dominant position or not, in the relevant market and also to decide whether or not there has been an abuse of dominant position. Further mere existence of dominance is not to be frowned upon unless the dominance is abused.

Merger, Amalgamations and Acquisitions Control

The Competition Act, 2002 uses the word combinations to cover acquisition of control, shares, voting rights and assets, and mergers and amalgamations.

Section 6 of the Competition Act, 2002 prohibits any person or enterprise from entering into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and if such a combination is formed, it shall be void.

Further Section 6(2) provides that any person or enterprise, who or which proposes to enter into any combination, shall give a notice to the Competition Commission of India, disclosing details of the proposed combination, in the form, prescribed and submit the form together with the prescribed fee within 30 days of –

- Approval of the proposal relating to merger or amalgamation, by the Board of Directors of the enterprise concerned with such merger or amalgamation, as the case may be;
- Execution of any agreement or other document for acquisition, acquiring of control.

The Competition Act, 2002 also sets a threshold below which a merger, acquisition or acquiring of control is not regarded as a combination.

Section 30 of the Competition Act, 2002 empowers the Competition Commission of India to determine whether the disclosure made to it under section 6(2) of the Act is correct and whether the combination has, or is likely to have, an appreciable adverse effect on competition in India. Upon receipt of notice for a proposed combination, the Commission must review the combination within tight time limits or else the combination is deemed to have been approved.

According to Section 31 of the Act, the Competition Commission of India may allow the combination if it will not have any appreciable adverse effect on competition in India or pass an order that the combination shall not take effect, if in its opinion, such combination has or is likely to have an appreciable adverse effect on competition.

The provisions of Section 6 do not apply to share subscription or financing facility or any acquisition, by a public financial institution, foreign institutional investor, bank or venture capital fund, pursuant to any covenant of a loan agreement or investment agreement.

Remedies under the Competition Act, 2002

CCI can be approached to report any unfair competition practices. CCI is also empowered to act *suo-moto* or on the reference.

Jurisdiction

Section 32 of the Competition Act, 2002 empowers the CCI to take action with respect to conduct that has occurred outside India and with respect to the parties located outside India provided that the conduct had an appreciable adverse effect on competition in the

relevant market in India. In support of this provision, Section 18 the Act empowers the CCI to enter into a memorandum or arrangement with any agency of any foreign country with the prior approval of the Central Govt.

Private enterprises as well as government owned enterprises and even government departments are covered by the provisions of Competition Act, 2002.

An enquiry or complaint could be initiated or filed before the Bench of CCI if within the local limits of its jurisdiction the respondents actually or voluntarily resides, carries on business or works for personal gain, or where the cause of action wholly or in part arises.

Competition Advocacy

The fourth element of a competition law is competition advocacy. Competition Advocacy is most crucial component of Competition Law. Central Government/State Government may seek the opinion of CCI on the possible effects of the policy on competition or any other matter. In this context, Section 49 of the Act envisages that while formulating a policy on the competition, the Government may make a reference to the CCI for its opinion on possible effect of such a policy on the competition, or any other matter. On receipt of such a reference, the CCI shall, give its opinion on it to the Central Government/State Government, within sixty days of making of such a reference and the Government may formulate policy as it deems fit. The role of CCI is advisory and the opinion given by the CCI shall not be binding upon the Central Government/State Government in formulating such a policy. Further the Act provides that the CCI shall take suitable measures for the promotion of competition advocacy, creating awareness and imparting training about competition issues.

Confidentiality

The Competition Act, 2002 recognizes that information received by the CCI could be commercially sensitive and its disclosure could result in harm to the business.

Section 57 of the Act provides that no information relating to any enterprise shall be disclosed without the prior written permission of the enterprise, except in compliance

with or for the purposed of this Act or for any other law for the time being in force. Thus it provides to enterprises the protection of confidentiality.

Penalties

The CCI has powers in relation to anti – competitive agreements and abuse of dominant positions. If the CCI finds that there is an unfair competition practice, which caused or is likely to cause an appreciable adverse effect on the competition in India, it may pass all or any of the following order –

- A cease and desist order, which directs the parties involved in such agreement or abuse of a dominant position to discontinue acting upon such agreement and not to re-enter such agreement, or to discontinue such abuse of a dominant position, as the case may be;

- An order which imposes a monetary penalty, as deemed fit but that does not exceed 10% of the average turnover for the last three preceding financial years, on each party to the agreement or abuse. Provided that in case of a cartel, the CCI may impose on each producer, seller, distributor, trader or service provider included in that cartel a penalty of up to three times its profit for each year of the continuance of such agreement or 10% its turnover for each that it continues such agreement, whichever is higher;

- An order directs that the agreement must stand modified to the extent and in the manner that may be specified in the order;

- An order that directs compliance with its orders and directions, including payment of costs;

- An order that directs the division of an enterprise that is abusing its dominant position to ensure that it can no longer abuse its dominance; and

- Any order or direction as the CCI deems fit.

Further, any person may apply to the Competition Appellate Tribunal for the recovery of compensation from any enterprise for any loss or damage shown to have been suffered by such person as a result of the enterprise –

- Violating directions issued by the CCI;
- Contravening, with no reasonable ground, any decision or order of the CCI issued under sections 27, 28, 31, 32 and 33 or any condition or restriction subject to which any approval, sanctions, directions or exemption in relation to any matter has been accorded, given, made or granted under the Competition Act; or
- Delaying in carrying out such orders or directions

Conclusion

The Indian Competition Act, 2002 is very much comprehensive and enacted to meet the requirements of the economic growth and international economic developments relating to competition laws. The legislation is in synchronization with other policies such as trade policy, FDI norms, FEMA etc, which would ensure uniformity in overall competition policy.

The Consumer Protection Law In India

The Consumer Protection Act, 1986 (CPA) is an Act that provides for effective protection of interests of consumers and as such makes provision for the establishment of consumer councils and other authorities that help in settlement of consumer disputes and matters connected therewith.



The CPA seeks to protect the interests of individual consumers by prescribing specific remedies to make good the loss or damage caused to consumers as a result of unfair trade practices.

Background

Unlike the law of torts which is not codified in India, there are certain legislations that have been formulated for the protection of interests of consumers. Some of the significant enactments that are aimed at protection of such interests of the consumers include the Sale of Goods Act, 1930, the Agricultural Produce (Grading and Marketing) Act, 1937, the Drugs and Cosmetics Act, 1940, the Indian Standards Institution

(Certification Marks) Act, 1952, the Food Safety and Standards Act, 2006, the Essential Commodities Act, 1955, the legal Metrology Act, 2009, etc.

These legislations contain regulatory provisions contravention of which, in most cases, attract civil liability. Earlier, the aggrieved consumer had no remedy but to initiate action by way of a civil suit, a lengthy and expensive process which caused undue harassment to the consumers. As a consequence, the cost and time involved was disproportionate to the compensation claimed and granted to the aggrieved consumer.

The CPA provides for quick and easy remedy to consumers under a three-tier quasi-judicial redressal agency at the District, State and National levels. The CPA has been amended from time to time to extend its coverage and scope and to enhance the powers of the redressal machinery.

Scope

Broadly speaking, the CPA seeks to protect the following basic rights of consumers:

- 
- Right against the marketing of goods and services which are hazardous to life and property;
 - Right to be informed about the quality, quantity, potency, purity, standard and price of goods or services;
 - Right to choice, wherever possible through access to a variety of goods and services at competitive prices;
 - Right to be heard and to be assured that consumers' interests will receive due consideration at appropriate forums;
 - Right to seek redressal against unfair trade practices or restrictive trade practices or unscrupulous exploitation of consumers;
 - Right to consumer education; and
 - Right to clean and healthy environment.

Who is a consumer?

Section 2(d) of the CPA defines "consumer" as a person who:

"(a) Buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for a consideration paid or promised or partly paid or partly promised, or under any system of deferred payment, when such use is made with the approval of such person, but does not include a person who obtains such goods for resale or for any commercial purpose;

or

(b) Hires or avails of any services for consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any beneficiary of such services other than the person who hires or avails of the services for a consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment, when such services are availed of with the approval of the first mentioned person but does not include a person who avails of such services for any commercial purpose. It may, however, be noted that "commercial purpose" does not include use by a person of goods bought and services exclusively for the purposes of earning his livelihood by means of self-employment."



From the above definition, it can be observed that:

- The goods or services must have been purchased or hired or availed of for a consideration which has been paid in full or in part or under a system of deferred payment, i.e., in respect of hire-purchase transactions;
- The goods purchased should not be meant for resale or for a commercial purpose. Goods purchased by a dealer in the ordinary course of his business and those which are in the course of his business to supply would be deemed to be for re-sale;
- In addition to the purchaser(s) of goods, or hirer(s) or user(s) of services, any beneficiary of such services, a user of goods/services with the approval of the

purchaser or hirer or user would also be deemed to be a "consumer" under the Act.

Consumer Protection Council

The interests of consumers are sought to be protected and promoted under the Act inter alia by establishment of Consumer Protection Councils at the District, State and National levels.

Redressal Machinery under the Act

The Act provides for a three-tier quasi-judicial redressal mechanism at the District, State and National levels for redressal of consumer disputes and grievances, namely:

National Consumer Disputes Redressal Commission (commonly known as National Commission)

It has jurisdiction to entertain complaints where the value of goods/services complained against and the compensation, if any claimed, exceeds Rs.10,000,000 (Indian Rupees 10 Million).

State Consumer Disputes Redressal Commission (commonly known as State Commission)



It has jurisdiction to entertain complaints where the value of goods/services complained against and the compensation, if any claimed, exceeds Rs 2,000,000 (Indian Rupees 2 Million) but less than Rs 10,000,000 (Indian Rupees 10 Million).

District Consumer Disputes Redressal Forum (commonly known as District Forum)

It has jurisdiction to entertain complaints where the value of goods/services complained against and the compensation, if any claimed, is less than Rs 2,000,000 (Indian Rupees Two Million).

Applicability of the Law of Limitation

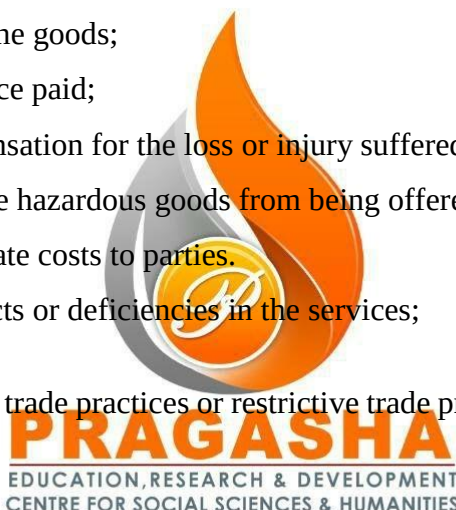
The District Forum, the State Commission and/or the National Commission shall not admit a complaint unless it is filed within two years from the date on which the cause of action has arisen. However, where the complainant satisfies the Forum/Commission, as the case may be, that he has sufficient cause for not filing the complaint within two years, such a complaint may be entertained by such Forum/ Commission after recording the reasons for condoning the delay.

Remedies under the CPA

Depending on the facts and circumstances, the redressal forums may issue orders for one or more of the following relief(s):

- Removal of defects from the goods;
- Replacement of the goods;
- Refund of the price paid;
- Award of compensation for the loss or injury suffered;
- Withdrawal of the hazardous goods from being offered for sale; or
- Award for adequate costs to parties.
- Removal of defects or deficiencies in the services;

Discontinuance of unfair trade practices or restrictive trade practices or direction not to repeat them;



The Relationship Between Competition Law And Consumer Protection

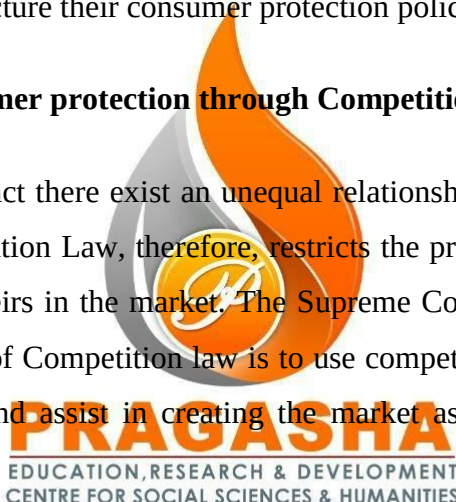
In the recent times, there has been major changes and emergence of various competitive practices in economies across the world. Due to the increasing competition, adverse consequences are produced. These repercussions do not remain limited to the market stakeholders but are extended to the consumers as well. The major problem arises when the effects of such competition become non-quantifiable and non-obvious. Until the late 1970s, there was no systematic movement in lieu of taking steps for the protection of interests of the consumers. In the recent consumer friendly environment, it is acknowledged that the true indicator of a country's development and its progressiveness is a level of consumer awareness and protection in the territory. The factors that have led to an increase in need of consumer protection are multifold. These include

increasing the complexity of production and distribution system, greater levels of sophistication in selling and marketing, advertising and promotional practices, increased mobility of consumers and lack of or reduction in the interaction between the consumers and sellers.

In order to tackle this problem, enactment of Competition laws is the best suitable recourse. Taking into consideration the consumer needs and imbalances faced by them in economic terms, education levels and bargaining power, there are various guidelines that have been made in furtherance of consumer protection. Such guidelines have been formulated or expanded to include 'sustainable consumption' as an important subject matter. These guidelines have been helpful in setting up international accepted set of objectives particularly for the developing countries in order to help them identify priorities and hence structure their consumer protection policies and legislations.

Enforcement of Consumer protection through Competition laws

It is an acknowledged fact there exist an unequal relationship between the producers and consumers. Competition Law, therefore, restricts the producers from abusing the dominant position of theirs in the market. The Supreme Court of India has observed that the main objective of Competition law is to use competition as a tool to promote economic efficiencies and assist in creating the market as responsive to consumer preferences.



Using Competition as a tool bears following benefits for the consumers:

- It is a means of lowering prices and improving quality. Consumer prices get lowered because with a better degree of competition, productivity of the industries increases. Not only consumer prices get lowered but also employment increases.
- It leads to consumer empowerment because of promotion of factors like higher degree of consumer protection, freedom of individual choice and abhorrence of concentration of power and decentralised economic efficiency
- It also aims for open market so that situations of shortages can be avoided, and therefore allocative efficiency may be increased;

- By achieving all these objectives growth and development get accelerated, and political and economic democracy gets preserved.
- It also produces better and wider choices.

It has been observed that there is a strong commonality between consumer protection policy on one hand and competition law and policy on the other hand. An effective and efficient competition policy if implemented in a proper manner can reduce the amount of trade barriers on entry and exit. Such reduction in barriers can help in making the market environment more conducive for not only promoting entrepreneurship but also for small and medium scale enterprises and their respective growth and provide scope for consequent expansion. Competition law and Policy aims at maintaining the ambit and process of competition between various enterprises and also provide for remedies to behavioural and structural problems so that competition can be re-established in the market. If all the above mentioned objectives are met then benefits like greater economic efficiency, higher innovation, and enhancement of consumer welfare can be achieved.

Consumer welfare would be achieved because now the consumers shall have greater choices and more availability of goods at reasonable and affordable prices. On the other hand, consumer policy deals with the nature of consumer transactions, steps, and strategies that can help in improving market conditions so that the consumers can effectively make an informed choice. Irrespective of the fact that the two policies focus on varying market failures and their respective remedies, but it is noteworthy that their aims coincide in a way that they both aim at maintenance of well-functioning and competitive markets that promote consumer welfare. It is because of this common feature that they are termed as mutually re-enforcing.

The ultimate objective of competition policy is to formulate such legal framework which shall empower other policies to facilitate competitive outcomes in the country. A good competition policy is not only an essential element of economic policy framework but also maximises consumer and social framework. It benefits the consumers in the way that it creates a business environment where efficient resource allocation is ultimately curbing or preventing abuse of market power.

In the Indian matrix, along with the Competition Act, it was suggested in the Tenth Five-year plan that a National Competition policy should also be articulated. This National Competition Policy would reflect nation's need for an accelerated economic growth and improvement in the quality of life of the people, nation's image and self-esteem etc. It was further put forth that the National Competition Policy would help in bringing about a competitive culture among various organisations, therefore maximising economic efficiency, protecting consumer interests and improving international competitiveness.

Provisions in the Competition Act that enforce consumer protection

Expressly, the Competition Act, 2002 gives protection to the consumers by way of Section 4, where it is recognised that an enterprise or group shall be termed as abusing its dominant position if it limits or restricts technical or scientific development relating to goods or services to the prejudice of consumers.^[1] Definition of the dominant position of a firm or enterprise is gauged by various factors. Among all other factors, it is defined as a position of strength enjoyed by an enterprise, in the relevant market, in India, which enables it to affect its consumers or the relevant market in its favour.

According to Section 18 of the Act, the Competition Commission of India has the power to take *suo moto* action in order to eliminate practices having adverse effect on competition, promote and sustain competition, protect the interests of consumers and ensure freedom of trade carried on by other participants, in markets in India.

According to Section 19(4), among other factors, dominant position is also determined by the dependence of consumers on the enterprise and entry barriers including barriers such as regulatory barriers, financial risk, high capital cost of entry, marketing entry barriers, technical barriers, economies of scale, high cost of substitutable goods or service for consumers. Section 19(6) and 19(7), the relevant geographical market and product market are determined by the many factors. One of the major factors among all others is consumer preferences.

Protection from the Unfair Trade Practices and Restrictive Trade Practices to consumers

The Competition Act, 2002 does not recognise unfair trade practices. Such practices have been recognised in the Consumer Protection Act, 1986, and any person found in contravention of such provisions is penalised. However, the Competition Act, 2002 recognises the Restrictive Trade Practices. A Restrictive Trade Practices is defined as the one which has the potential of bearing effects such as preventing, distorting or restricting competition. In particular, any trade practice that obstructs the flow of capital or resources into the stream of production can be termed as Restrictive Trade Practice. Examples of such practice include price manipulation, the imposition of such conditions on the delivery or supply of goods that have an effect of imposing unjustified costs and restrictions etc.

THE ENVIRONMENT (PROTECTION) ACT, 1986

The Act came into force on Nov. 19, 1986, the birth anniversary of our Late Prime Minister Indira Gandhi, who was a pioneer of environmental protection, issues in our country. The Act extends to whole of India. Some terms related to environment have been described as follows in the Act:

- *Environment* includes water, air and land and the inter-relationships that exist among and between them and human beings, all other living organisms and property. .
- *Environmental pollution* means the presence of any solid, liquid or gaseous substance present in such concentration, as may be, or tend to be, injurious to environment.
- *Hazardous Substance* means any substance or preparation which by its physico-chemical properties or handling is liable to cause harm to human beings, other living organisms, property or environment.

The Act has given powers to the Central Government to take measures to protect and improve environment while the state governments coordinate the actions. The most important functions of Central Govt. under this Act include setting up of:

- (a) The standards of quality of air, water or soil for various areas and purposes,
- (b) The maximum permissible limits of concentration of various environmental pollutants (including noise) for different areas.

- (c) The procedures and safeguards for the handling of hazardous substances.
- (d) The prohibition and restrictions on the handling of hazardous substances in different areas.
- (e) The prohibition and restriction on the location of industries and to carry on process and operations in different areas.
- (f) The procedures and safeguards for the prevention of accidents which may cause environmental pollution and providing for remedial measures for such accidents.

The power of entry and inspection, power to take sample etc. under this Act lies with the Central Government or any officer empowered by it.

For the purpose of protecting and improving the quality of the environment and preventing and abating pollution, standards have been specified under Schedule I-IV of Environment (Protection) Rules, 1986 for emission of gaseous pollutants and discharge of effluents/waste water from industries. Under the Environmental (protection) Rules, 1986 the State Pollution Control Boards have to follow the guidelines provided under Schedule VI, some of which are as follows:

(a) They have to advise the Industries for treating the wastewater and gases with the best available technology to achieve the prescribed standards.

(b) The industries have to be encouraged for recycling and reusing the wastes.

(c) They have to encourage the industries for recovery of biogas, energy and reusable materials.

(d) While permitting the discharge of effluents and emissions into the environment, the State Boards have to take into account the assimilative capacity of the receiving water body.

(e) The Central and State Boards have to emphasize on the implementation of clean technologies by the industries in order to increase fuel efficiency and reduce the Under the Environment (Protection) Rules, 1986 an amendment was made in 1994 for

Environmental Impact Assessment (EIA) of Various Development Projects. There are 29 types of projects listed under Schedule I of the rule, which require clearance from the Central Government before establishing.

DRAWBACKS OF POLLUTION RELATED ACTS

- The power and authority has been given to central government with little delegation of power to state government. Excessive centralization very often hinders efficient execution of the provisions of the Acts in the states. Illegal mining is taking place in many forest areas. In Rajasthan alone, about 14000 cases of illegal mining have been reported. It becomes more difficult to check such activities at the central level.
- The provision of penalties in the Act is very insignificant as compared to the damage caused by the big industries due to pollution. The penalty is much less than the cost of the treatment/ pollution control equipment. This always gives a loose rope to the industries.
- The Act has not included the "right to information" for the citizens. This greatly restricts the involvement or participation of the general public.
- The Environment (protection) Act, 1986 regarded as an umbrella Act, encompassing the earlier two acts often seems superfluous due to overlapping areas of jurisdiction. For instance Section 24 (2) of the new Act has made a provision that if the offender is punishable under the other Acts like Water Act or Air Act also, then he may be considered under their provisions. Interestingly, the penalty under the older two Acts is much lighter than the new Act. So the offender easily gets away with a lighter punishment.
- Under Section 19, a person cannot directly file a petition in the court on a question of environment and has to give a notice of minimum 60 days to the central government. In case the latter takes no action, then alone the person can file a petition, which certainly delays the remedial action.
- Litigation, particularly related to environment is very expensive, tedious and difficult since it involves expert testimony, technical knowledge of the issues and terminology,

technical understanding of the unit process, lengthy prosecutions etc. • The State Boards very often lack adequate funds and expertise to pursue their objectives.

- A tendency to seek to exercise gentle pressure on the polluter and out of the court settlements usually hinders the implementation of legal measures.
- For small units it is very expensive to install Effluent Treatment Plant (ETP) or Air pollution control devices and sometimes they have no other option but to close the unit. The Act should make some provision for providing subsidies for installing treatment plants or common effluent treatment plants for several small units.
- The pollution control laws are not backed by sound policy pronouncements or guiding principles.
- Political appointee usually occupies the position of chairman of the boards. Hence it is difficult to keep political interference at bay.
- The policy statement of the Ministry of Environment and Forests (1992) of involving public in decision-making and facilitating public monitoring of environmental issues has mostly remained on paper.



Environmental policies and laws need to be aimed at democratic decentralization of power, community-state partnership, administrative transparency and accountability and more stringent penalties to the offender. There is also a need for environmental law education and capacity building in environmental issues for managers.

PUBLIC ENVIRONMENTAL AWARENESS

- Some of the main reasons responsible for widespread environmental ignorance can be summed up as follows:
- Our courses in Science, technology, economics etc. have so far failed to integrate the knowledge in environmental aspects as an essential component of the curriculum.
- Our planners, decision-makers, politicians and administrators have not been trained so as to consider the environmental aspects associated with their plans.

- In zeal to go ahead with some ambitious development projects, quite often there is purposeful concealment of information about environmental aspects.
- There is greater consideration of economic gains and issues related to eliminating poverty by providing employment that overshadows the basic environmental issues.

Methods to Propagate Environmental Awareness

Environmental awareness needs to be created through formal and informal education to all sections of the society. Everyone needs to understand it because 'environment belongs to all' and 'every individual matters' when it comes to conservation and protection of environment. Various stages and methods that can be useful for raising environmental awareness in different sections of the society are as follows:

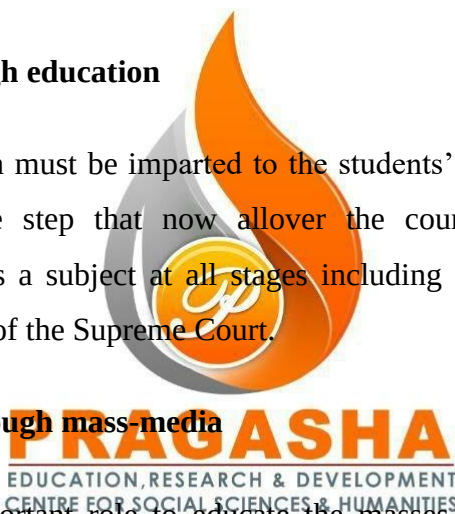
Among students through education

Environmental education must be imparted to the students' right from the childhood stage. It is a welcome step that now all over the country we are introducing environmental studies as a subject at all stages including school and college level, following the directives of the Supreme Court.

Among the Masses through mass-media

Media can play an important role to educate the masses on environmental issues through articles, environmental rallies, plantation campaigns, street plays, real eco-disaster stories and success stories of conservation efforts. TV serials like *Virasat*, *Race to save the Planet*, *Heads and Tails*, *Terra-view*, *Captain planet* and the like have been effective in propagating the seeds of environmental awareness amongst the viewers of all age groups. **Among the planners, decision-makers and leaders**

Since this elite section of the society plays the most important role in shaping the future of the society, it is very important to give them the necessary orientation and training through specially organized workshops and training programmes.



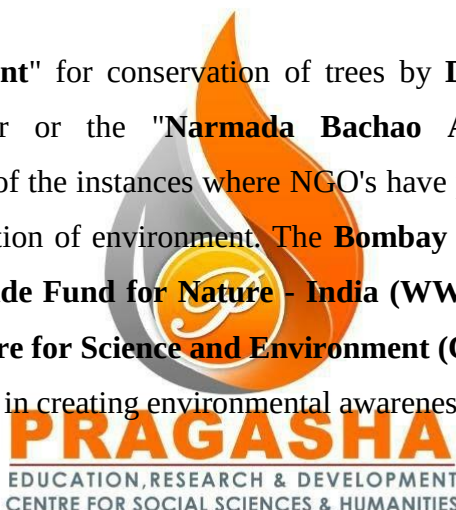
Publication of environment - related resource material in the form of pamphlets or booklets published by Ministry of Environment & Forests could also help in keeping this section abreast

of the latest developments in the field.

Role of Non-Government Organizations (NGO's)

Voluntary organizations can help by advising the government about some local environmental issues and at the same time interacting at the grass-root levels. They can act as an effective and viable link between the two. They can act both as an 'action group' or a 'pressure group'. They can be very effective in organizing public movements for the protection of environment through creation of awareness.

The "**Chipko :Movement**" for conservation of trees by **Dasholi Gram Swarajya Mandal** in Gopeshwar or the "**Narmada Bachao Andolan**" organized by **Kalpavriksh**, are some of the instances where NGO's have played a landmark role in the society for conservation of environment. The **Bombay Natural History Society (BNHS)**, the **World Wide Fund for Nature - India (WWF, India)** **Kerala Sastra Sahitya Parishad**, **Centre for Science and Environment (CSE)** and many others are playing a significant role in creating environmental awareness through research as well as extension work.



SUMMARY

There are various environmental pollution, have harmful effects on human beings as well as on animal, plants and each and every units of this world. To control these, various control measures must be implemented effectively. The effective implementation of environmental legislation could play an important role to reduce the harmful impact up to significant extent. Various voluntary organizations have contributed in this regard.

Generation of Economic Reforms

- The reform process in India was initiated with the aim of accelerating the pace of economic growth and eradication of poverty. The process of economic liberalization in

India can be traced back to the late 1970s. However, the reform process began in earnest only in July 1991.

- With the onset of the reforms the Government signaled a systemic shift to a more open economy with greater reliance upon market forces, a larger role for the private sector including foreign investment, and a restructuring of the role of Government. The reforms of the last two and a half decades have gone a long way in freeing the domestic economy from the control regime.
- An important feature of India's reform programme is that it has ***emphasized gradualism and evolutionary transition*** rather than rapid restructuring or “shock therapy”.

First Generation Reforms (1991 onwards)

- It had its origin in 1985 when the New Economic Policy declared emphasised on improvement in productivity, absorption of modern technology and fuller utilisation of capacity and finally on the greater role for the private sector.
- The economic reforms initiated in 1991 introduced far-reaching measures, which changed the working and machinery of the economy. The reforms have unlocked India's enormous growth potential and unleashed powerful entrepreneurial forces.
- Since 1991, successive governments have successfully carried forward the country's economic reform agenda in response to the changes in the nature of markets and institutions, industrial organisation and structures and social relations of production.
- These changes were pertinent to the following:
 - Dominance of the public sector in the industrial activity
 - Discretionary controls on industrial investment and capacity expansion
 - Trade and exchange controls
 - Limited access to foreign investment
 - Public ownership and regulation of the financial sector
- The focus of reforms was mostly on stabilization with a little stress on structural reforms.

- New policy introduced various changes regarding industrial licensing, technology up-gradation, elimination of controls and restrictions, foreign capital, fiscal policy, rationalizing and simplifying the system of fiscal and administrative regulation and export-import policy in order to provide greater scope to private sector.

- The policy changes were expected to provide a big boost in private sector investment particularly in the corporate segment of manufacturing industry which would, in turn usher in rapid growth of the economy as well as pave the way for modernization of the economy.

- **Broader Reforms among First Generation were as follows:**

- Chelliah Committee suggestions in Taxation, focus was on broadening the Tax Base.
- Narasimham Committee suggestions for Financial Sector, focus was on increasing stability.
- LPG reforms through New Industrial Policy, focus was on freeing the economy from clutches of ageing public sector.
- Partial convertibility of Rupee in Current Account.

Second Generation Reforms

- In a way the Second Generation Reforms began in earnest in 1999. India embarked on an exercise of cutting personal taxes, investing in infrastructure and creating world class companies.

- Second generation of economic reforms in the country gave special stress on ***fiscal reforms, financial reforms, structural reforms, labour law reforms etc.*** Major fiscal reforms have been undertaken for broadening the income tax base and streamlining the excise and customs duty structures.

- Major financial sector reforms undertaken by the government include allowing private companies to enter into insurance sector, allowing foreign bank to open their branches in India.



- The focus of reforms was on structural reforms through institutional strengthening. Overall, the objective was to push economy on a higher growth trajectory & the second generation reforms did pushed India to 8% growth path as against 6% growth path that was guided by first generation reforms.

• **Broader Reforms among Second Generation were as follows –**

- Foreign Exchange – Abolition of (FERA) Foreign Exchange Regulation Act and creation of (FEMA) Foreign Exchange Management Act; Partial convertibility of Rupee in Capital Account on basis of Second Tarapore Committee

- Labour – Voluntary Retirement Scheme (VRS); Board for Industrial and Financial Reconstruction (BIFR); National Renewal Fund

- Financial Sector – Narasimham Committee II suggestions regarding prudential norms and the Capital Adequacy Ratio (CAR)

- Taxation – Value Added Tax (VAT); Kelkar Panel Suggestions on Direct tax; Provision of Minimum Alternate Tax (MAT), Fringe Benefit Tax (FBT) and other tax avoidance aspects; Introduction of service tax



Third Generation Reforms

PRAGASHA
EDUCATION, RESEARCH & DEVELOPMENT
CENTRE FOR SOCIAL SCIENCES & HUMANITIES

- Currently India is under 3rd generation of reforms.

- The First & Second generation of reforms had a few downsides. The GDP had been growing but the GDP per capita still left a lot to be desired. India ranks much lower than Asian and Latin American peers when compared on parameters like GDP per capita and Tax/GDP. This is one of the first challenges before the Indian government.

- The second challenge was the creation of world class infrastructure. We are not only referring to infrastructure in terms of roads, railways and ports; but also in terms of manufacturing and manpower infrastructure.

- The third area of focus is on creating, encouraging and nurturing the spirit of entrepreneurship.

• **Broader Reforms among Third Generation were as follows:**

- GST (Goods and Service Tax)
- Exit Policy/ Bankruptcy Code
- Capital easing norms for start-ups or entrepreneurs through Mudra Bank

Economic Reforms in India: First and Second Phase

Economic Reforms—The First Phase:

With the changes in the nature of markets and institutions, industrial organisation and structures and social relations of production in various countries of the world, India has also started to respond to all these changes, particularly to the increasing globalisation of economic processes.

The first phase of economic reforms that had its origin in 1985 when Mr. Rajiv Gandhi took over as the Prime Minister of the country. Just after that Mr. Gandhi declared the New Economic Policy where he put much emphasis on improvement in productivity, absorption of modern technology and fuller utilisation of capacity and finally on the greater role for the private sector.

In order to provide greater scope to private sector, this new policy introduced various policy changes regarding industrial licensing, technology up-gradation, elimination of controls and restrictions, foreign capital, fiscal policy, rationalizing and simplifying the system of fiscal and administrative regulation and export-import policy.

These policy changes were brought with the sole-intention to create a favourable climate for getting a big boost in private sector investment which would, in turn usher in rapid growth of the economy as well as pave the way for modernization of the economy.

In this connection, Prof. K.N. Raj rightly observed that, “There has been, however, a general agreement that a very distinctive feature of these policy changes taken as a whole is the greater scope for unfettered expansion they offer to the private sector, particularly in the corporate segment of manufacturing industry and the opportunities opened up to multi-national enterprise.”

Accordingly, the New Economic Policy stressed on removing unnecessary restrictions in issuing licences, in denying Industrial Licences to MRTP companies and in making adjustment of output to administered prices.

In this connection, the government introduced various measures in the following manner:

1. Cement:

Cement was totally decontrolled and a number of private sector units were issued additional licensed capacities.

2. Sugar:

The share of free sale of sugar in open market was enlarged.

3. Asset limit:

The ceiling of the asset limit of big business houses was enhanced from Rs. 20 crores to Rs. 100 crores.

4. Broad-banding:

The scheme of “broad-banding” of licences was introduced to bring variety in the production of two wheelers which was later extended to 25 other categories of industries like, four-wheelers, chemicals, petro-chemicals, pharmaceuticals, typewriters-etc.

5. Drug:

94 drugs were completely delicensed and 27 industries were placed outside the purview Of MRTP Act.

6. Textile:

Introduction of new Textile Policy, 1985 practically abolished the distinction between mill, power loom and handloom sectors and also between natural and synthetic fibre for licensing purposes.



7. Electronics:

Electronics industry was liberalised from MRTP Act restrictions. The entry of FERA Companies in the areas was also liberalised.

8. Foreign Trade:

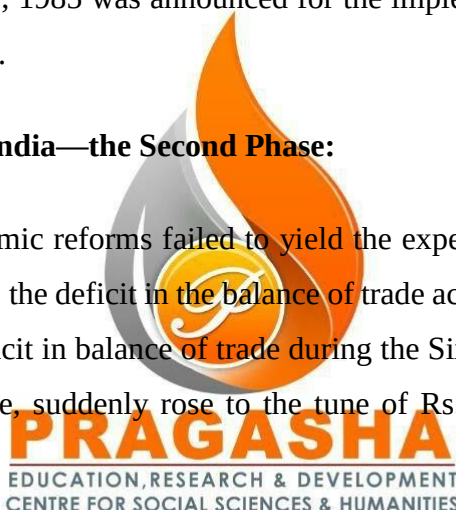
Export-Import Policy, 1985 was announced in order to pave the way for easier and quicker access to imports, strengthening export production base and for facilitating technological up-gradation.

9. LTFP:

Long Term Fiscal Policy, 1985 was announced for the implementation of the Seventh Plan in a smooth manner.

Economic Reforms in India—the Second Phase:

The first phase of economic reforms failed to yield the expected result in most of the fronts. More particularly, the deficit in the balance of trade account gradually increased and thus the average deficit in balance of trade during the Sixth Plan which was to the extent of Rs. 5,935 crore, suddenly rose to the tune of Rs. 10,841 crore during the Seventh Plan.



Moreover, receipts on invisible account has also declined Thus the country has been plunged into a serious balance of payments crisis. In order to save the situation, the Government approached the World Bank and the International Monetary Fund (IMF) to extend loan to the tune of about \$7 billion. IMF finally decided to advance this loan but at the same times insisted that the Government should put the economy again on right track.

Accordingly, Dr. Manmohan Singh, the then Finance Minister of India finally made a commitment by his letter dated August 27, 1991 to the IMF Managing Director Michel Camdessus that the Government of India set certain macro-economic targets and also initiated certain policy measures in order to bring about structural readjustment of the economy.

In order to restore both internal and external confidence, the Narasimha Rao Government initiated a good number of stabilisation measures in 1991-92. These measures include—tightening of monetary policy by raising interest rates, adjustment of the exchange rate of rupee by 22 per cent, liberalisation and simplification of foreign trade policy, reduction of fiscal deficit and introduction of other reforms in economic policy necessary to bring a new element of dynamism to the process of economic growth of the country.

The memorandum submitted by the then Finance Minister observed that, “The thrust will be to increase the efficiency and international competitiveness of industrial production, to utilize foreign investment and technology to a much greater degree than in the past, to improve the performance and rationalize the scope of the public sector and to reform and modernize the financial sector so that it can more efficiently serve the needs of the economy.”

Macro-Economic objectives:

The main macro-economic objectives of economic reforms (2nd phase) in India include:

- 
- (a) Attaining economic growth at the rate of 3 to 3.5 per cent in 1991-92 and at 4 per cent in 1992-93;
 - (b) Reducing the annual rate of inflation by 9 per cent in 1991-92 followed by 6 per cent in 1992-93;
 - (c) Relieving the critical balance of payments situation and rebuilding foreign exchange reserves to \$ 2.2 billion in 1991-92;
 - (d) Reducing current account deficit in the budget from 2.5 per cent of GDP in 1990-91 to 2.0 per cent by 1992-93.

Policy Measures of Second Phase of Economic Reforms:

The following are the major areas of the second phase of economic reforms in India:

1. Fiscal Policy Reforms:

The Government initiated various fiscal measures in order to reduce the fiscal deficit from 8.4 per cent of GDP in 1990-91 to 5.0 per cent in 1996-97 and to 3.7 per cent in 2006-2007. In order to achieve this target, the Government introduced various controls over public expenditure and took initiative to raise both its tax and non-tax revenue.

The other measures include imposition of fiscal discipline by both Central and State Governments, reduction of subsidies, developing a more efficient expenditure system, encouraging state governments to streamline the working State Enterprise, more particularly State Electricity Boards and State Transport Corporations and withdrawal of budgetary support to Central public sector enterprises and to improve their profitability and efficiency.

2. Monetary Policy Reforms:

The Government pursued a restrictive monetary policy for reducing inflationary pressures and also for improving balance of payment position.

3. Pricing Policy Reforms:

In order to reduce budgetary provision for subsidies and to promote a more flexible price structure, the Government increased the administered prices of various commodities and inputs (petroleum products and fertilizers) and gave greater freedom to public sector enterprises to set price as per market forces.

4. External Policy Reforms:

The government introduced stabilisation and import compression measures in order to reduce the current account deficit in balance of payments to 2.1 per cent of GDP in 1991-92 and then to 2 per cent of GDP in 1992-93.

5. Industrial Policy Reforms:

In order to make necessary reforms in its industrial policy, the Government introduced its new industrial policy on July 24, 1991.



The various measures under industrial policy reforms include:

- (a) Abolition of the scheme of industrial licensing for all industrial projects excepting 18 industries related to security, strategic or environmental concerns etc.;
- (b) De-reservation of the area of public sector from 17 to 8 industries in order to open up area of investment for the private sector;
- (c) Elimination of the system of pre-entry scrutiny of investment decisions of the MRTP companies and controlling only “unfair or restrictive business practices”;
- (d) Liberalisation of location policy;
- (e) Abolition of phased manufacturing programmes earlier enforced to increase the pace of indigenisation and
- (f) Removal of mandatory convertibility clause.

6. Foreign Investment Policy Reforms:

The new industrial policy, 1991 made provision for increased flow of foreign investment in connection with technology transfer, marketing expertise and introduction of modern managerial techniques. Accordingly, the new policy included 34 priority industries in Annexure III to give automatic permission for foreign direct investment up to 51 per cent foreign equity.

In respect of foreign technology agreements automatic permission will be provided in high priority industry for royalty payments up to 5 per cent on domestic sales, 8 per cent on export sales or a maximum payment of Rs. 1 crore. Moreover, in order to promote exports of Indian commodities in international market, foreign trading companies were also allowed to raise their foreign equity holdings up to 51 per cent for export activities.

7. Public Sector Policy Reforms:

Considering the huge amount of losses incurred by a good number of public sector enterprises, the Government has taken various policy measures of making necessary reforms of the public sector.

These policy measures include:

- (a) Reservation of list of industries under public sector reduced to 8 as against 17 industries reserved earlier;
- (b) Review of those public investments be made in order to avoid those areas where social considerations are not so paramount and where private sector investment would be more efficient;
- (c) Enterprises earning higher profit and judged appropriate, will be provided with much higher degree of arrangement autonomy through the system of MOD;
- (d) Progressive reduction of budgetary support of public enterprises;
- (e) Inviting private sector participation to increase market discipline and also the competitive capacity of these public sector enterprises through disinvestment of part of equity of selected enterprises;
- (f) Referring the chronically sick public enterprises to the Board for Industrial and Financial Reconstruction (BIFR) for its rehabilitation, reconstruction or rationalisation.

In the mean time, the Government has taken decision to dereserve the area of industries and thus reduced the number of industries reserved for public sector to 8 and also allow private sector participation even in these 8 areas selectively. The Government also allowed joint ventures with foreign companies.

The Government has also decided to disinvest 20 per cent of the equity of public enterprises to selective private sector enterprises. Accordingly, in 1991-92 and in 1992-93, Rs. 3,038 crore and Rs. 1,866 crore respectively were raised through disinvestment of PSE shares.

In 1993-94, the Government realised Rs. 2,291 crore against the targeted amount of Rs. 3,500 crore and in 1994-95, the Government plans to mobilise Rs. 4,000 crore through

disinvestment of PSUs shares but it realised Rs. 5,237 crore. A National Renewal Fund (NRF) has also been created for training and redeployment of workers and also to provide voluntary retirement compensation.

Game Plan for Public Sector Reform, 1994-95:

On February 8, 1994, the Government announced a “game plan” for the public sector reform in 1994-95 which gave more emphasis on improving dynamic efficiency and quality check of the performance and also to give more weight (50 per cent) for profit and profit related criteria in the memorandum of understanding (MOU) to improve the financial performance of the public sector.

Originally no weight was given to profit when MOU was introduced in 1988. It subsequently raised to 35 per cent in 1993-94 and the weight has been substantially stepped up to 50 per cent for 1994-95.

The Government has already evolved a six-year action plan to restructure public sector undertakings and the idea is to have 100 per cent weight for profit at the end of six years to make the public enterprises fully run on commercial lines.

8. Trade Policy Reform:

In the context of globalisation of the economy and also to promote international integration of our country, phasing out of excessive and indiscriminate protection given to domestic industry become necessary. This would develop a vibrant export sector and create a regime of price based system.

The main objective is to eliminate progressively the system of licenses and quantitative restrictions, particularly for capital goods and raw materials so that these items can be placed easily on open general license (OGL). The new policy made provision for reduction of the scope of public sector monopoly sharply for most export items and also a good number of import items.

In this context, the Government has introduced Export-Import Policy, 1992-97 and 1997-2002 for the coming five years and on 13th April 1998 the Government has further modified this new Exim Policy (1997-2002) and also announced its annual Exim

Policy, 2000-01 and also in 2001-2002; Again on 31st March, 2002, the Government announced its new Exim Policy, 2002-07 so as to achieve 1 per cent share in global exports by 2007.

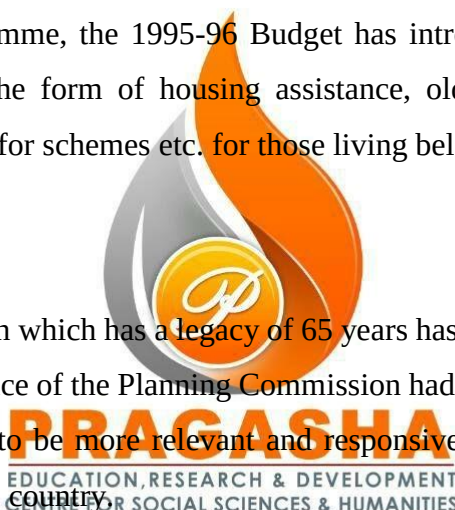
9. Social Policy Reforms:

To meet the objective of poverty alleviation as a part of our adjustment process, the government has allocated a higher amount of outlays on elementary education, rural drinking water supply, assistance to small and marginal farmers, programmes for the welfare of scheduled caste and scheduled tribe and other weaker sections of the society, programme for women and children and also on infrastructure and employment generation projects.

As a part of this programme, the 1995-96 Budget has introduced a National Social Assistance Scheme in the form of housing assistance, old age pension, maternity benefit, group insurance for schemes etc. for those living below the poverty line.

Niti Aayog

The planning commission which has a legacy of 65 years has replaced by NITI Aayog. The utility and significance of the Planning Commission had been questioned for long. The replacement seems to be more relevant and responsive to the present economic needs and scenario in the country.



EVOLUTION OF NITI AAYOG

NITI AAYOG

The NITI Aayog was formed on January 1, 2015. In Sanskrit, the word “NITI” means morality, behavior, guidance, etc. But, in the present context, it means policy and the NITI stand for National Institution for Transforming India. It is country’s premier policy-making institution which is expected to bolster the economic growth of the country. It aims to construct a strong state that will help to create a dynamic and strong nation. This helps India to emerge as a major economy in the world. The NITI Aayog’s creation has two hubs called “Team India Hub” and Knowledge and innovation Hub.

1. The Team India: It leads the participation of Indian states with the central government.
2. The Knowledge and innovation hub: it builds institution's think tank capabilities.

NITI Aayog is additionally creating itself as a State of the Art Resource Center, with the essential resources, knowledge, and skills that will empower it to act with speed, advance research and innovation, bestow crucial policy vision to the government and manage unforeseen issues. The reason for setting up the NITI Aayog is that the people had expectations for growth and development in the administration through their participation. This required institutional changes in administration and active strategy shifts that could seed and foster substantial scale change. The institution has completed one year of its life.

OBJECTIVES OF NITI AAYOG

1. The active participation of States in the light of national objectives and to provide a framework 'national agenda'.
2. To promote cooperative federalism through well-ordered support initiatives and mechanisms with the States on an uninterrupted basis.
3. To construct methods to formulate a reliable strategy at the village level and aggregate these gradually at higher levels of government.
4. Economic policy that incorporates national security interests
5. To pay special consideration to the sections of the society that may be at risk of not profiting satisfactorily from economic progress.
6. To propose strategic and long-term policy and programme frameworks and initiatives, and review their progress and their effectiveness.
7. To grant advice and encourage partnerships between important stakeholders and national- international Think Tanks, as well as educational and policy research institutions.
8. To generate a knowledge, innovation and entrepreneurial support system through a shared community of national and international experts etc
9. To provide a platform for resolution of inter-sectoral and inter-departmental issues in order to speed up the accomplishment of the progress agenda.

10. To preserve a state-of-the-art Resource Centre, be a repository of research on good governance and best practices in sustainable and equitable development as well as help their distribution to participants.
11. To effectively screen and assess the implementation of programmes and initiatives, including the identification of the needed resources to strengthen the likelihood of success.
12. To pay attention to technology improvement and capacity building for the discharge of programs and initiatives.
13. To undertake other necessary activities in order to the implementation of the national development agenda, and the objectives.

7 PILLARS OF NITI AAYOG

The NITI Aayog is based on the 7 pillars of effective Governance. They are:

1. Pro- People: it fulfills the aspirations of society as well as individuals
2. Pro-activity: in anticipation of and response to citizen needs
3. Participation: involvement of citizenry
4. Empowering: Empowering, especially women in all aspects
5. Inclusion of all: inclusion of all people irrespective of caste, creed, and gender
6. Equality: Providing equal opportunity to all especially for youth
7. Transparency: Making the government visible and responsive



COMPOSITION OF NITI AAYOG

The NITI Aayog will comprise the following:

1. **Prime Minister** of India is the Chairperson
2. **Governing Council** consists of the Chief Ministers of all the States and Lt. Governors of Union Territories in India.
3. **Regional Councils** will be created to address particular issues and possibilities affecting more than one state. These will be formed for a fixed term. It will be summoned by the Prime Minister. It will consist of the Chief Ministers of States and Lt. Governors of Union Territories. These will be chaired by the Chairperson of the NITI Aayog or his nominee.

4. **Special invitees:** Eminent experts, specialists with relevant domain knowledge, which will be nominated by the Prime Minister.

5. The full-time organizational framework will include, in addition to the Prime Minister as the Chairperson:

- Vice-Chairperson (will be appointed by the Prime Minister)

- Members:

→ Full-time

→ Part-time members: Maximum of 2 members from foremost universities, leading research organizations and other innovative organizations in an ex-officio capacity. Part-time members will be on a rotational basis.

- Ex Officio members: Maximum of 4 members of the Council of Ministers which is to be nominated by the Prime Minister.

- Chief Executive Officer: CEO will be appointed by the Prime Minister for a fixed tenure. He will be in the rank of Secretary to the Government of India.

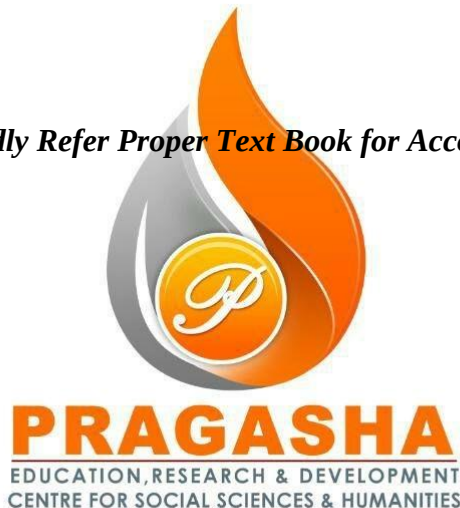
The Secretariat as deemed necessary.



Unit – 2: Financial & Management Accounting

- ✓ Basic Accounting Concepts, Capital and Reserves, Financial Statement
- ✓ Partnership Accounts: Admission, Retirement, Death, Dissolution and Capital Distribution
- ✓ Advanced Company Accounts: Issue, Forfeiture, Purchase of Business, Liquidation, Valuation of Shares, Amalgamation, Absorption and Reconstruction, Holding Company Accounts
- ✓ Cost and Management Accounting: Ratio Analysis, Fund Flow Analysis, Cash Flow Analysis, Marginal Costing and Break Even Analysis, Standard Costing, Budgetary Control, Costing For Decision Making
- ✓ Responsibility Accounting

Kindly Refer Proper Text Book for Accounting



Unit – 3: Business Economics

- ✓ Natural and Uses of Business Economics, Concept of Profit and Wealth Maximization. Demand Analysis and Elasticity of Demand, Indifference Curve Analysis, Law of Utility Analysis, Law of Return and Law of Variable Proportions
- ✓ Cost, Revenue, Price Determination in Different Market Situation: Perfect Competition, Monopolistic Competition, Monopoly, Price Discrimination and Oligopoly, Price Strategies

UNIT – 3: BUSINESS ECONOMICS

DEMAND ANALYSIS

It is necessary to estimate the demand for the goods or services before they are produced and provided. The producers, for this purpose, heavily depend upon the data relating to the pattern of consumption of these goods and services. The demand analysis provides them the basis to take decisions relating to volume of production (How many products required to produce), capital to be invested (How much amount to be invested) and so on.

DEMAND

Demand for a commodity refers to the quantity of the commodity which an individual consumer is willing to purchase at a particular time at a particular price.

A product or service is said to have demand when three conditions are satisfied.

- (a) Desire to acquire - Desire of the consumer to buy the + Product
- (b) Willingness to pay - His willingness to buy the product and
- (c) Ability to pay - Ability to pay the specified price for it.

Nature and types of Demand:

Demand for the product is determined by its nature. Demand for such commodities which use indispensable for the consumer is not affected significantly by changes in their market conditions. In other words, a product with more number of uses is naturally more number

of uses is naturally more in demand than one with a single use, the nature of demand is better understood when we see these variations given below:

(1) Consumer goods v/s producer goods:

Consumer Goods:

Consumer goods refer to such products and services which are satisfying consumer need. Consumer goods are those which are available for ultimate consumption. Consumer goods are needed for direct consumption and gives direct and immediate satisfaction.

For Ex : Bread, Apple, Rice and so on

Producer Goods:

Producer goods are those which are used for producing other goods. Producer goods are those which are used for further processing or production of goods services to cash income. These goods give satisfaction indirectly.

For Ex: Machines, Steel, Tools, etc.

There could be cases where a given product may be both producer and also consumer goods.

For Ex: A farmer having ten bags of paddy may use five bags for his personal consumption and other five bags as seeds for the next crop. In such a case, paddy is both producer good and consumer good.

2. Autonomous Demand v/s Derived Demand:

Autonomous Demand:

Autonomous demand refers to the demand for products and services directly and independently.

For Ex : Demand for two wheelers is autonomous demand.

Derived Demand:

In case of derived demand, the demand for a product arises due to purchase of another product.

For Ex: (1) Demand for petrol because two wheelers

(2) If there is a demand for house, then there is a demand for cement, iron and bricks.

3. Durable Goods v/s Perishable Goods:

Durable Goods:

Durable Goods are those which give service relatively for a long period.

For Ex : T.V., Washing Machine, etc.

Perishable Goods:

Perishable Goods are those which give service relatively for a short period.

For Ex: Milk, vegetables, fish, rice, etc.

4. Firm Demand v/s Industry Demand :

Firm Demand:

The firm is a single business unit (single company). The term “Firm Demand” denotes demand for a particular product of a particular firm (company). For Ex: The demand of LG TVs is referred as Firm Demand Or Company Demand.

Industry Demand:

Industry refers to the group of companies producing same type of product. Industry Demand refers to the total demand for the product of a particular industry.

For Ex: Demand for TVs produced by all companies is Referred as Industry Demand.

5. New Demand v/s Replacement:

New Demand refers to the demand for the new products and it is addition to the existing stock.

Replacement Demand:

Replacement demand may also refer to the demand resulting out of replacing the existing asset with the new ones.

For Ex: Purchasing a new TV and replacing with old is Referred as replacement demand.

6. Total market and segment market demand:

Total Market Demand:

Total market demand means the total demand for a product in a given total market.

Segment Market Demand:

Segment market demand refers to the demand of product in particular market segment of a total market.

For Ex: If a product selling in Andhra Pradesh total demand means that total demand to the that product in A.P. Market segment demand means the demand in a particular area. For Ex : Demand in Nellore segment of total A.P. Market.

Factors determining the Demand (or)

Demand Determined

The demand for a particular product depends on several factors. The following factors determine the demand for a given product.

- a) Price of the product (P)
- b) Income of the consumer (I)
- c) Taste and performance of the consumer (T)

- d) Price of related goods (Substitute or complementary) (P_r)
- e) Expectations about the prices in future (E_p)
- f) Expectations about the income in future (E_i)
- g) Size of the population (S_p)
- h) Distribution of consumers over different regions (De_i)
- i) Advertising effort (A_c)
- j) Any other factors capable of affecting the demand (O)

(1) Price of the product (P):

The most important factor which influences the demand is price. A decrease in the price of a normal good leads to rise in demand of a product. Similarly, an increase in the price will reduce the demand for a commodity. The relation between price and demand is inverse relationship.

(2) Income of the consumer (I)

When the income of the consumer is increased, the consumer purchases more quality of goods. When the income of consumer is decreased, the consumer purchases less quality of goods. The income of the consumer and demand of a product moves in the same direction.

(3) Tastes and preference of the consumer (T):

We know it quit well that the change in tastes and preferences of a consumer in favor of a commodity results in increasing demand for a commodity, while if this change is against the commodity it results in smaller demand for the commodity.

(4) Price of the related goods (P_r) (Substitute and complementary Goods): When a change in the price of one commodity influences the demand for other commodity. The related commodities are two types :

- (a) Substitutes
- (b) Complements

(a) Substitute Goods:

When the price of one commodity increase, then the demand for another product will increase.

For Ex: In case of Tea and Coffee, when coffee price increased then the demand for tea will increase. Likewise (i.e., both increase together or decrease together)

(b) Complementary goods:

When the price of one commodity, will increase, then the demand for another product will decrease. For Ex: Bread and butter, Pen and ink, Petrol and automobiles

(5) Expectations about future price of the product (E_p) :

If the consumer expects future price of the product will increase, then the consumer purchase more quantity of goods at present. Similarly, if the price of the product in the future will decrease, then the demand at present will decrease.

(6) Expectations about future income of the consumer (E_f)

In case, the consumer expects a higher income in future, he spends more at present to purchase more quantity of goods. Similarly, the consumer expects a lower income in future, he spends less at present to purchase less quantity of goods.

(7) Advertisement (AE):

If we can spent more amount on advertisement to influence the consumer, the demand will increase, if advertisement expenditure is less, then the demand will decrease.

Demand Function:

A mathematical expression of the relationship between quantity demanded of the commodity and its determinants. Demand function is a function which describes the relationship between demand and its determinants.

It describes how much quantity of goods is bought at alternative prices of goods and related goods, alternative income levels, alternative various demand determinants mathematically, the demand function for a product can be expressed as follows:

$$Q_d = f(P, I, T, PR, EP, EI, SP, DC, A, O)$$

Where

Q_d = Quantity of demand

P = Price of the product

I = Income of the consumer

T = Tastes and preference

PR = Price of related goods

EP = Expected price of the product in future

EI = Expected income of the consumer in future

SP = Size of the population

DC = Distribution of consumers over various regions

A = Advertisement expenditure

O = Any another factor which influence the demand

LAW OF DEMAND

The law of demand states: When the price of a product will increase, then the demand for the product will decrease. Similarly, when the price of the product decreased, the demand will increase when remaining things are constant.

Law of Demand table

Price of product	Demand of product
2	10
4	8
6	6
8	4
10	2

Exceptions to the law of Demand:

There are certain exceptions to the law of demand in other words, the law of demand is not applicable in the following cases.

(1) Giffen Goods: People whose incomes are low purchase more of a commodity such broken rice, bread, potato (which is their staple food) when its prices rises. Inversely when its price falls, instead of buying more, they buy less of this commodity and use the savings for the purchase of better goods such as meat. This phenomenon is called Giffens paradox and such goods are giffen goods.

(2) Veblen Goods: Products such as jewels, diamonds and so on confer distinction on the part of the user. In such case, the consumers tend to buy more goods when price increased, and less purchase when price decreased. Such goods are called Veblen Goods.

(3) Where there is a shortage of necessities: If the consumers fear that there could be shortage of necessities, then this law of demand does not applicable. They may tend to buy more than what they require immediately, even if the price of the product increases.

(4) In case of ignorance of price changes: When the customer is not familiar with the changes in the price, he tends to buy even if there is increase in price.

Production Function

Production is an important economic activity which satisfies the wants and needs of the people. Production function brings out the relationship between inputs used and the resulting output. A firm is an entity that combines and processes resources in order to produce output that will satisfy the consumer's needs. The firm has to decide as to how

much to produce and how much input factors (labour and capital) to employ to produce efficiently. This chapter helps to understand the set of conditions for efficient production of an organization.

Factors of production include resource inputs used to produce goods and services. Economist categories input factors into four major categories such as land, labour, capital and organization.

Land: Land is heterogeneous in nature. The supply of land is fixed and it is a permanent factor of production but it is productive only with the application of capital and labour.

Labour: The supply of labour is inelastic in nature but it differs in productivity and efficiency and it can be improved.

Capital: is a man made factor and is mobile but the supply is elastic.

Organization: the organization plans, , supervises, organizes and controls the business activity and also takes risks.

Production Function

Production function indicates the maximum amount of commodity 'X' to be produced from various combinations of input factors. It decides on the maximum output to be produced from a given level of input, and how much minimum input can be used to get the desired level of output.

The production function assumes that the state of technology is fixed. If there is a change in technology then there would be change in production function.

$$Q = f(\text{Land, Labour, Capital, Organization})$$

$$Q = f(L, L, C, O)$$

The production manager's responsibility is that of identifying the right combination of inputs for the decided quantity of output. As a manager, he has to know the price of the input factors and the budget allocation of the organization. The major objective of any business organization is maximizing the output with minimum cost. To achieve the



maximum output the firm has to utilize the input factors efficiently. In the long run, without increasing the fixed factors it is not possible to achieve the goal. Therefore it is necessary to understand the relationship between the input and output in any production process in the short and long run.

Cobb Douglas Production Function:

This is a function that defines the maximum amount of output that can be produced with a given level of inputs. Let us assume that all input factors of production can be grouped into two categories such as labour (L) and capital (K). The general equilibrium for the production function is

$$Q = f(K, L)$$

There are various functional forms available to describe production. In general Cobb-Douglas production function (Quadratic equation) is widely used

$$Q = A K^\alpha L^\beta$$

Q = the maximum rate of output for a given rate of capital (K) and labour (L).

Short Run Production Function:

In the short run, some inputs (land, capital) are fixed in quantity. The output depends on how much of other variable inputs are used. For example if we change the variable input namely (labour) the production function shows how much output changes when more labour is used.

In the short run producers are faced with the problem that some input factors are fixed. The firms can make the workers work for longer hours and also can buy more raw materials. In that case, labour and raw material are considered as variable input factors. But the number of machines and the size of the building are fixed. Therefore it has its own constraints in producing more goods.

In the long run all input factors are variable. The producer can appoint more workers, purchase more machines and use more raw materials. Initially output per worker will increase up to an extent. This is known as the **Law of Diminishing Returns** or the **Law**

of Variable Proportion. To understand the law of diminishing returns it is essential to know the basic concepts of production.

Measures of Productivity

Total production (TP): the maximum level of output that can be produced with a given amount of input.

Average Production (AP): output produced per unit of input $AP = Q/L$

Marginal Production (MP): the change in total output produced by the last unit of an input

Marginal production of labour = $\Delta Q / \Delta L$ (i.e. change in the quantity produced to a given change in the labour)

Marginal production of capital = $\Delta Q / \Delta K$ (i.e. change in the quantity produced to a given change in the capital)

Production Function:

A production function, like any other function can be expressed and analyzed by any one or more of the three tools namely table, graph and equation. The maximum amounts of output attainable from various alternative combinations of input factors are given in the table.

The production function expressed in tabular form is as follows.

Table - Production Schedule

Labor TP AP MP

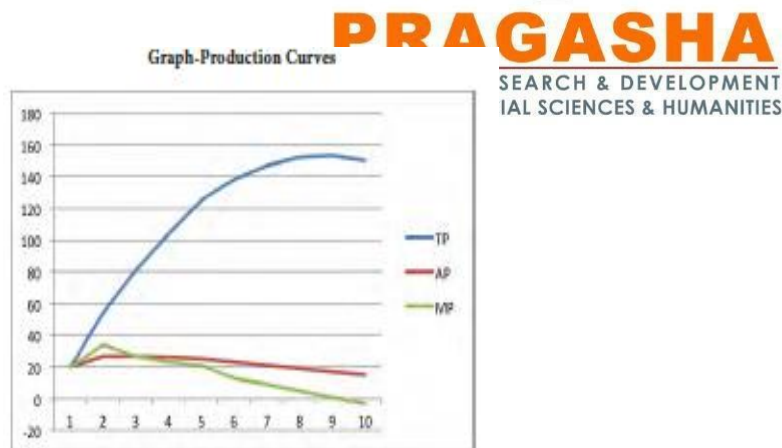


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Labour	TP	AP	MP
1	20	20	0
2	54	27	34
3	81	27	27
4	104	26	23
5	125	25	21
6	138	23	13
7	147	21	9
8	152	19	5
9	153	17	1
10	150	15	-3

The firm has a set of fixed variables. As long with that it increases the labour force from 1 unit to 10 units. The increase in input factor leads to increase in the output up to an extent. After that it start declining. Marginal production increases in the initial period and then it starts declining and it become negative. The firm should stop increasing labour force if the marginal production is zero- that is the maximum output that can be derived with the available fixed factors. The 9th labour does not contribute to any output. In case the firm wants to increase the output beyond 153 units it has to improve its fixed variable. That means purchase of new machinery or building is essential. Therefore the firm understands that the maximum output is 153 units with the given set of input factors.

The graphical representations of the production function are as shown in the following graph.



The graphical presentations of the values are shown in the graph. The 'X' axis denotes the labour and the 'Y' axis indicates the total production (TP), average production (AP) and marginal production (MP). From the given table and graph we can understand all the three

curves in the graph increased in the beginning and the marginal product (MP) first fell, then the average product (AP) finally total production (TP). The marginal production curve MP cuts the AP at its highest point. Total production TP falls when marginal production curve cuts the 'X' axis. The law of diminishing returns states that if increasing quantity of a variable input are combined with fixed, eventually the marginal product and then average product will decline.

When the production function is expressed as an equation it shall be as follows:

$$Q = f(L_d, L, K, M, T)$$

It can be expressed as $Q = f_1, f_2, f_3, f_4, f_5 > 0$

Where,

Q = Output in physical units of good X

L_d = Land units employed in the production of Q

L = Labour units employed in the production of Q

K = Capital units employed in the production of Q

M = Managerial Units employed in the production of Q

T = Technology employed in the production of Q

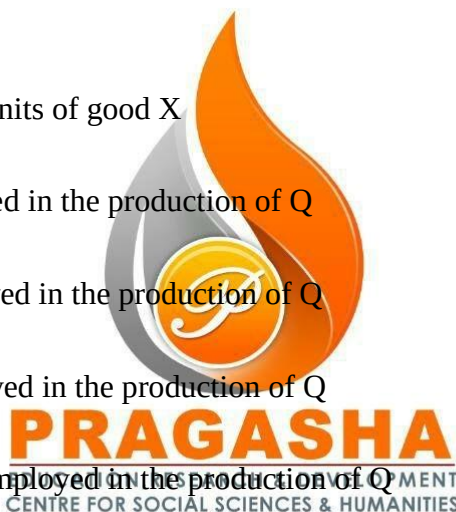
f = Unspecified function

f_i = Partial derivative of Q with respect to i th input.

This equation assumes that output is an increasing function of all inputs.

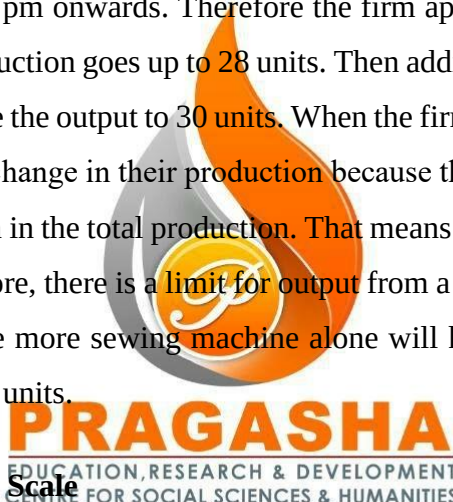
The Law Of Diminishing Returns

In the combination of input factors when one particular factor is increased continuously without changing other factors the output will increase in a diminishing manner. Let us assume that a person preparing for an examination continuously prepares without any



break. The output or the understanding and the coverage of the syllabus will be more in the beginning rather than in the later stages. There is a limit to the extent to which one factor of production can be substituted for another. The total production increases up to an extent and it gets saturated or there won't be any change in the output due to the addition of the input factor and further it leads to negative impact on the output. That means the marginal production declines up to an extent and it reaches zero and becomes negative. The point at which the MP becomes zero is the maximum output of the firm with the given set of input factors. This law is applicable in all human activities and business activities.

For example with two sewing machines and two tailors, a firm can produce a maximum of 14 pairs of curtains per day. The machines are used only from 9 AM to 5 PM and the machines lie idle from 5 pm onwards. Therefore the firm appoints 2 more tailors for the second shift and the production goes up to 28 units. Then adding two more labour to assist these people will increase the output to 30 units. When the firm appoints two more people, then there won't be any change in their production because their Marginal productivity is zero. There is no addition in the total production. That means there is no use of appointing two more tailors. Therefore, there is a limit for output from a fixed input factors but in the long run purchase of one more sewing machine alone will help the firm to increase the production more than 30 units.



The Law of Returns To Scale

In the long run the fixed inputs like machinery, building and other factors will change along with the variable factors like labour, raw material etc. With the equal percentage of increase in input factors various combinations of returns occur in an organization.

Returns to scale: the change in percentage output resulting from a percentage change in all the factors of production. They are increasing, constant and diminishing returns to scale.

Increasing returns to scale may arise: if the output of a firm increases more than in proportionate to an increase in all inputs. For example the input factors are increased by 50% but the output has doubled (100%).

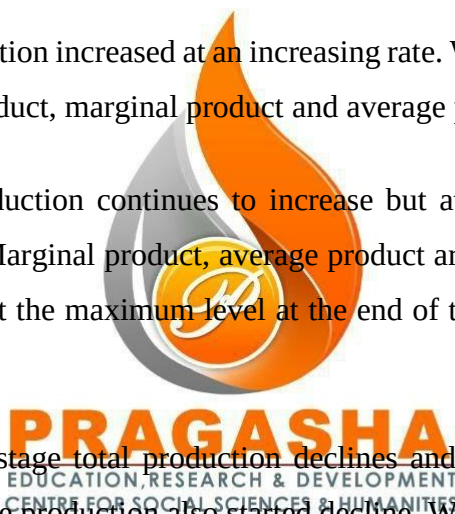
Constant returns to scale: when all inputs are increased by a certain percentage the output increases by the same percentage. For example input factors are increased by 50% then the output has also increased by 50 percentages. Let us assume that a laptop consists of 50 components we call it as a set. In case the firm purchases 100 sets they can assemble 100 laptops but it is not possible to produce more than 100 units.

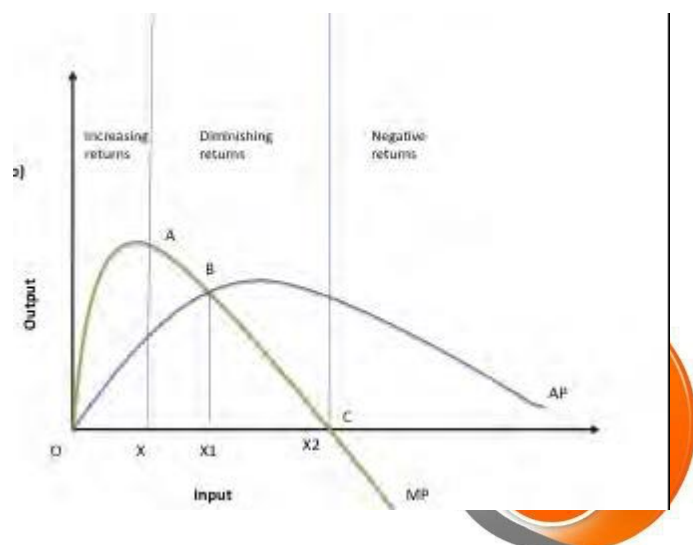
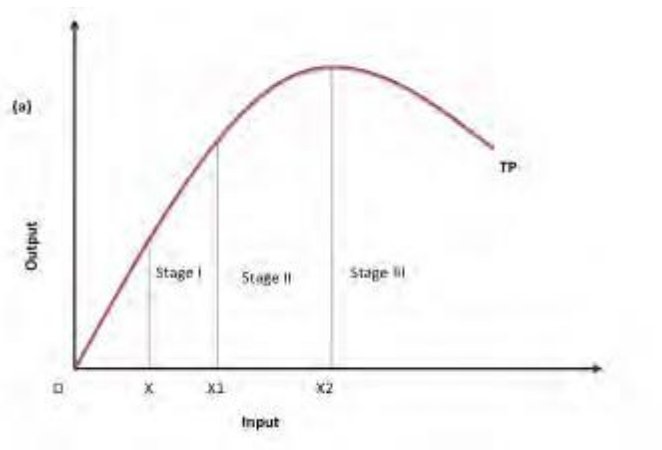
Diminishing returns to scale: when output increases in a smaller proportion than the increase in inputs it is known as diminishing return to scale. For example 50% increment in input factors lead to only 20% increment in the output. From the graph given below we can see the total production (TP) curve and the marginal production curve (MP) and average production curve (AP). It is classified into three stages; let us understand the stages in terms of returns to scale.

Stage I: The total production increased at an increasing rate. We refer to this as increasing stage where the total product, marginal product and average production are increasing.

Stage II: The total production continues to increase but at a diminishing rate until it reaches the next stage. Marginal product, average product are declining but are positive. The total production is at the maximum level at the end of the second stage with a zero marginal product.

Stage III: In this third stage total production declines and marginal product becomes negative. And the average production also started decline. Which implies that the change in input factors there is a decline in the overall production along with the average and marginal. In economics, the production function with one variable input is illustrated with the well known law of variable proportions. (below graph) it shows the input-output relationship or production function with one factor variable while other factors of production are kept constant. To understand a production function with two variable inputs, it is necessary know the concept **iso-quant or iso-product curve**.



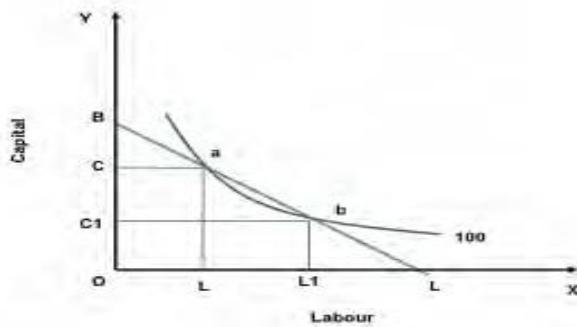


ISO-Quants

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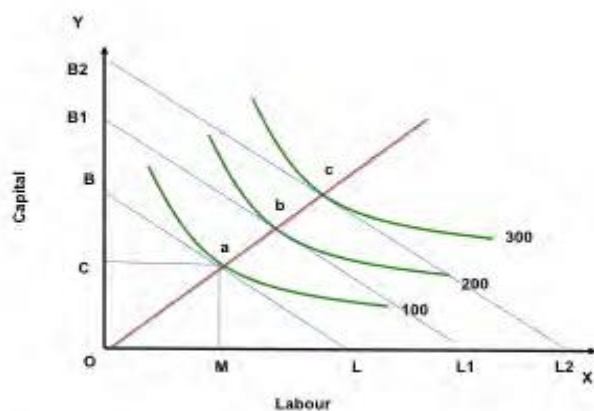
To understand the production function with two variable inputs, iso-quant curve is used. These curves show the various combinations of two variable inputs resulting in the same level of output. The shape of an Iso-quant reflects the ease with which a producer can substitute among inputs while maintaining the same level of output. From the graph we can understand that the iso-quant curve indicates various combinations of capital and labour usage to produce 100 units of motor pumps. The points a, b or any point in the curve indicates the same quantum of production. If the production increases to 200 or 300 units definitely the input usage will also increase therefore the new iso-quant curve for 200 units (Q_1) is shifted upwards. Various iso-quant curves presented in a graph is called as iso-quant map.

Iso-cost: different combination of inputs that can be purchased at a given expenditure level.



The above graph explains clearly that the iso quant curve for 100 units of motor consists of 'n' number of input combinations to produce the same quantity. For example at 'a' to produce 100 units of motors the firm uses OC amount of capital and OL amount of labour ie., more capital and less labour force. At 'b' OC1 amount of capital and OL1 labour force is used to produce the same that means more labour and less capital.

Optimal input combination: The points of tangency between iso quant and iso cost curves depict optimal input combination at different activity levels.



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Expansion path: Optimal input combinations as the scale of production expand. From the graph it is clear that the optimum combination is selected based on the tangency point of iso cost (budget line) and iso- quant ie., a, b respectively. The point 'a' indicates that to produce 100 units of motor the best combination of capital and labour are OC and OM which is within the budget. Over a period of time a firm will face various optimum levels if we connect all points we derive expansion path of a firm.

Managerial Uses Of Production Function:

Production functions are logical and useful. Production analysis can be used as aids in decision making because they can give guidance to obtain the maximum output from a given set of inputs and how to obtain a given output from the minimum aggregation of inputs. The complex production functions with large numbers of inputs and outputs are analyzed with the help of computer based programmes.

NATIONAL INCOME

National income estimates are the most reliable macroeconomic indicators of an economy. Therefore, it is essential for students to be aware of National Income Concepts. Changes in national income measure the rate of growth of the economy.

Similarly, changes in the structure of national income of an economy reflect the changing significance of different sectors. In India, national income, as also per capita income, have been continuously increasing. In more recent years, the rate of growth of national income has accelerated. It indicates that the economy has been growing at a faster rate in recent years than in the past. Along with this, the structure of national income has also undergone a change, the tertiary sector has emerged as the dominant sector of the economy.

The task of preparing national income estimates has been assigned to the Central Statistical Organisation (CSO). The CSO has been producing annual official estimates of national income of India since 1955 and publishing the same in its annual report *National Accounts Statistics*.

Concept of National Income

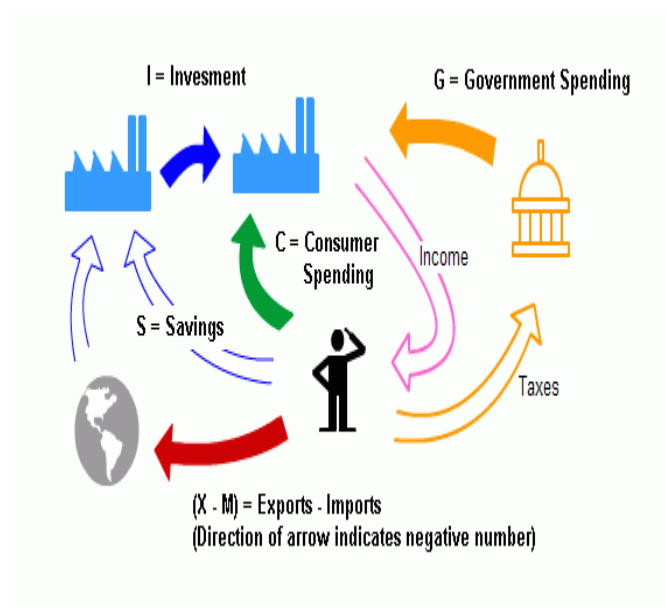
National income accounting comprises of four concepts of calculations- GDP, NDP, GNP, NNP.

Here, we discuss them and other related terms in a very objective way.

1. Factor cost is the input cost that producer has to incur in the process of production. It includes cost of capital – loan interest, prices of raw materials, labour, power, rent, etc. Can be termed as Production cost.

2. Market cost is calculated after adding indirect taxes to the factor cost of the product. It is basically the cost at which the goods reach the market. Also termed as EX-FACTORY PRICE. In India we calculate income at factor cost because of non-uniform taxes.

- National Income: The sum total of factor of incomes accruing to the residents of the country, both from their activities within and outside the economic territory is the national income of the country.
- National income is calculated for a particular period, normally a financial year (In India, financial year means April 1 to March 31 of next year). Net factor income from abroad is added to the domestic product to get the value of National Income.



- National Income = $C + I + G + (X - M)$
 Where, C = Total consumption expenditure
 I = Total investment expenditure
 G = Total government expenditure ; $X - M$ = Export – Import

The **National Income concepts** include the following important terms:

Gross Domestic Product (GDP)

Gross domestic product is the value of all final goods and services produced within the boundary of a nation during one year. In India one year means from 1st April to 31st March of the next year.

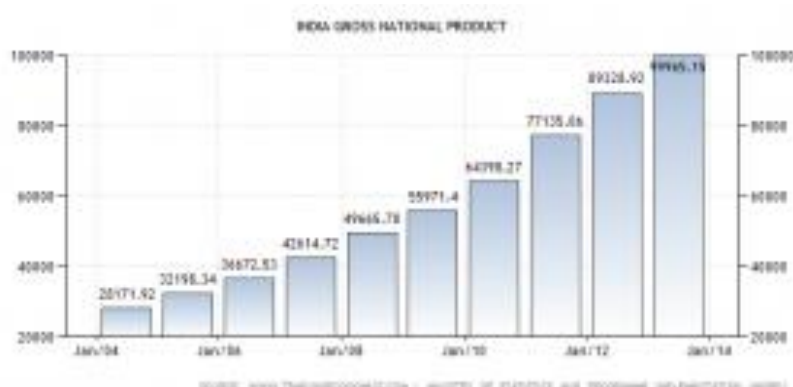
GDP calculation includes income of foreigners in a Country but excludes income of those people who are living outside of that country.

Net Domestic Product (NDP)

NDP is calculated by deducting the depreciation of plant and Machinery from GDP.

NDP = Gross Domestic Product – Depreciation

Gross National Product (GNP)



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GNP of India

GNP is the value of all final goods and services produced by the residents of a country in a financial year (i.e., 1st April to 31st March of the next year in India).

While Calculating GNP, income of foreigners in a country is excluded but income of people who are living outside of that country is included. It is the GDP of a country added with its income from abroad.

GNP = GDP + X – M

Where, X = income of the people of a country who are living outside of the Country

and M = income of the foreigners in a country

- India's GNP is always lower than its GDP.
- This is the national income according to which the IMF ranks nations.

- It allows for knowledge of factors in production behaviour and pattern of an economy's dependence on outside world, nature of human resources internationally, position in world economics.
- It indicates both qualitative as well as quantitative aspects of an economy in a more exhaustive fashion than GDP.

Intermediate products = one production unit purchasing from other for resale

Final product = all goods and services purchased for consumption and investment , and not for resale

Value added = Value of output – Intermediate cost

Gross value added = net value added + depreciation

Indirect tax = all taxes levied on production, finally paid by consumer of buyer Ex – sales tax, excise, customs

Subsidies = Financial help given by the government to the production units for selling the product at lower prices

Net National Product (NNP)

Net National Product (NNP) in an economy is the GNP after deducting the loss due to depreciation.

$NNP = GNP - \text{Depreciation}$

- NNP at Factor Cost: It is the value of NNP when the value of goods and services is taken at the production cost.
- NNP at Market Price: It is the value of NNP at consumer cost.

$NNP \text{ at market cost} = NNP \text{ at factor cost} + \text{Indirect taxes} - \text{Subsidies}$

Closed Economy: An economy that does not maintain any economic relations with the rest of the world. **Economic Goods:** Those goods which are scarce in supply and, hence, command a price.

Economic Growth: A sustained increase in real national income of a country.

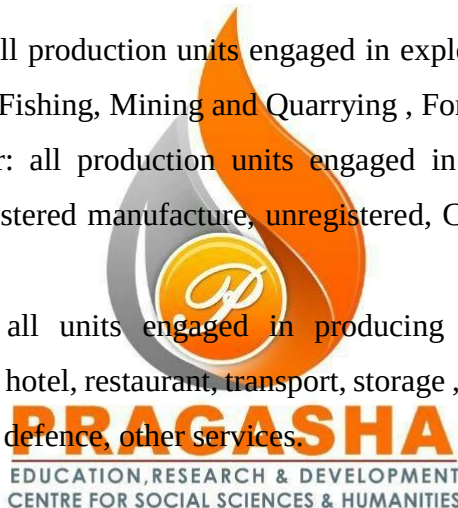
Nominal National Income: The money value of all the final goods and services produced in an economy during a year, estimated at current prices.

Real National Income: The money value of all the final goods and services produced in an economy during a year, estimated at some fixed prices.

Subsidy: It is the grant given on current account by the Government to the private industries and public corporations for selling certain goods at a price fixed by the Government.

National Income Measurement:

- Primary sector: all production units engaged in exploitation of natural resources like Agriculture, Fishing, Mining and Quarrying , Forestry and Logging
- Secondary sector: all production units engaged in transforming one good to another like Registered manufacture, unregistered, Construction, Electricity Gas Water supply.
- Tertiary sector: all units engaged in producing services like Banking and Insurance, Trade, hotel, restaurant, transport, storage , Real estate dwelling, Public administration & defence, other services.



Unit – 4: Business Statistics and Data Processing

- ✓ Data Types, Data Collection and Analysis, Sampling, Need, Errors and Methods of Sampling, Normal Distribution, Hypothesis Testing, Analysis and Interpretation of Data
- ✓ Correlation and Regression, Small Sample Tests – T-Test, F -Test and Chi Square Test
- ✓ Data Processing - Elements, Data Entry, Data Processing and Computer Application
- ✓ Computer Application to Functional Areas – Accounting, Inventory Control And Marketing

STATISTICS



P C Mahalanobis, known as father of Indian Statistics. A statistical laboratory was developed by him at Presidency College and later this formed the foundation for the famous Indian Statistical Institute at Kolkata. One of his important contribution was in designing and conducting large scale surveys. He introduced the concept of pilot surveys and advocated the usefulness of sampling methods.

The word ‘Statistics’ has its root either to Latin word ‘Status’ or Italian word ‘Statista’ or German word ‘Statistik’ each of which means a ‘political state’. The word ‘Statistics’ was primarily associated with the presentation of facts and figures pertaining to demographic, social and political situations prevailing in a state/government. Its evolution over time formed the basis for most of the science and art disciplines. Statistics is used in the developmental phases of both theoretical and applied areas, encompassing the field of Industry, Agriculture, Medicine, Sports and Business analytics.

Statistics is concerned with scientific method for collecting, organizing, summarizing, presenting, analyzing and interpreting of data. The word statistics is normally referred either as numerical facts or methods.

Definition of Statistics

"Statistics refers to the classified facts representing the conditions of the people in the State ... especially those facts which can be stated in numbers or in tables of numbers or in any tabular classified arrangement". - Webster

"Statistics are collection of noteworthy facts concerning state both historical and descriptive". - Gotfriedand Achenwall

"Statistics is an aggregate knowledge brought together for a practical end namely the knowledge of concrete states". – Wappans

"Statistics is numerical statement of facts in any development of enquiry placed in relation to each other". - Bowley

“By statistics, we mean quantitative data affected to a marked extent by multiplicity of causes”. – Kendal

‘Statistics is the science which deals with the collection, presentation, analysis and interpretation of numerical data’ - Croxton and Cowden

Wallist and Roberts defines statistics as “Statistics is a body of methods for making decisions in the face of uncertainty”

Laws of Statistics

There are two important laws of statistics on which whole theory of sampling is based. These two laws are:

– Law of Statistical Regularity

– Law of Inertia of a Large Numbers

1. Law of Statistical Regularity: This law provides the basis of theory of probability in statistics. According to this law, if a large sample is taken from a population in a random way, it is bound to be fairly representative of the population. Prof. W.I. King has rightly observed in this regard. "The law of statistical regularity formulated

in a mathematical theory of probability lays down that a moderately large number of items chosen at random from a very large group are almost sure on the average to have the characteristics of the large group". This law holds good if it meets the following two conditions.

- random sample is taken
- the size of sample is large

2. Law of Inertia of Large Numbers: This law is corollary of the law of statistical regularity. This law states that the larger the size of sample, the more accurate the results are likely to be. It is because large numbers have greater stability, steadiness, consistency as compared to small numbers.

DATA

The word 'data' was first used in 1640's. In 1946, the word 'data' also meant for "transmittable and storable computer information". In 1954, a term called 'data processing' was introduced. The plural form of 'datum' is 'data'. It also means "given" or "to give" in Latin.

Information, especially facts or numbers collected for decision making is called data. Data may be numerical or categorical. Data may also be generated through a variable.

Variable

A variable is an entity that varies from a place to place, a person to person, a trial to trial and so on. For instance the height is a variable; domicile is a variable since they vary from person to person.

A variable is said to be quantitative if it is measurable and can be expressed in specific units of measurement (numbers).

A variable is said to be qualitative if it is not measurable and cannot be expressed in specific units of measurement (numbers). This variable is also called categorical variable.

The variable height is a quantitative variable since it is measurable and is expressed in a number while the variable domicile is qualitative since it is not measured and is expressed as rural or urban. It is noted that they are free from units of measurement.

Quantitative Data:

Quantitative data (variable are measurements that are collected or recorded as a number. Apart from the usual data like height, weight etc.,

Qualitative Data:

Qualitative data are measurements that cannot be measured on a natural numerical scale. For example, the blood types are categorized as O, A, B along with the Rh factors.

They can only be classified into one of the pre assigned or pre designated categories.

Measurement Scales

There are four types of data or measurements scales called nominal, ordinal, interval and ratio. These measurement scales is made by Stanley Stevens.

- Nominal scales: Nominal measurement is used to label a variable without any ordered value.
- Ordinal scales: These data share some properties of numbers of arithmetic but not all properties. In the ‘ordinal scales’ it is the order that matters, and that is all we get from these. It is to be noted that the mean cannot be computed from the ordinal data, but either median or mode can be computed.
- Interval scales: In an interval scale one can also carryout numerical differences but not the multiplication and division. In other words, an interval variable has the numerical distances between any two numbers.
- Ratio scales: Ratio scales are important when it comes to measurement scales because they tell us about the order, they tell us the exact value between units, and they also have an absolute zero—which allows for a wide range of both descriptive and inferential statistics to be applied.

Points to Remember

- Tabulation refers to systematic and logical arrangement of data in columns and rows in accordance with some salient features and characteristics. A tabular arrangement of data with corresponding frequency is known as frequency distribution.
- Presentation of data is to graphically represent the classified and tabulated data. There are number of diagrams which can be used for the presentation of data. The selection of a particular diagram depends upon the nature of data, objective of presentation and the ability and experience of the person doing this task. Some of the important types of diagram include line diagram, Simple Bar Diagram, Multiple Bar Diagram, Sub-divided or Component Bar Diagram, Circular or Pie Chart and scatter diagram.
- Central tendency can be measured by mean, median, or mode; Measures of dispersion, such as standard deviation and coefficient of variation can also be calculated from ratio scales.
- A measure of Central Tendency or an average of a distribution is a single figure which can be regarded as a representative of the whole distribution. An average is a single value within the range of data that is used to represent all values in the series. Since an average is somewhere within the range of the data, it is also called a measure of Central Value.
- The objectives and significance of statistical averages include presentation of huge mass of data in summarized form, facilitation of comparison, help indecision making and establishing the precise relationships.
- There are two types of averages i.e. mathematical and positional. Mathematical averages include the measures such as arithmetic mean, geometric mean and harmonic mean whereas positional averages include measures like median and mode.
- Bivariate analysis is one of the simplest form of statistical analysis. It is related to the analysis of two variables for the purpose of determining the empirical relationship between them.
- Covariance indicates how two variables are related. A positive covariance means the variables are positively related, while a negative covariance means the variables are inversely related.
- If change in one variable is accompanied by change in other variable, both the variables are known as correlated. There are number of examples, which shows such

kind of relationship like, age and playing habit, rainfall and production of crop and so on. The degree of relationship is measured through the correlation analysis.

The major preliminaries to data collection:

- a. The **objectives** of the statistical research
- b. The **available scope** of the statistical research
- c. The **statistical units** for the research – should be unambiguous and specific to the research. They should also be stable and uniform in the usage of statistical technique. Moreover, statistical units should be appropriate to the research and should not digress from the main objective. They can either be a collection of units or a collection of analysis and interpretation.
- d. Various **sources** of data (in case of primary data) and information (in case of secondary data)
- e. **Methods** of collecting data – are either census method or sample technique.
- f. The **degree of accuracy** of the final results
- g. Different **types** of enquiry (or research) – are official, confidential, regular, sample, census and primary research. Secondary, ad-hoc, repetitive and direct are also examples of types of enquiries.

TYPES OF DATA

There are 2 types of data. Discussed below are the types of data.

1. **Primary Data** – refers to the data that the investigator collects for the very first time. This type of data has not been collected either by this or any other investigator before. A primary data will provide the investigator with the most reliable first-hand information about the respondents. The investigator would have a clear idea about the terminologies used, the statistical units employed, the research methodology and the size of the sample. Primary data may either be internal or external to the organization.
2. **Secondary Data** – refers to the data that the investigator collects from another source. Past investigators or agents collect data required for their study. The investigator is the first researcher or statistician to collect this data. Moreover, the investigator does not have a clear idea about the intricacies of the data. There may be ambiguity in terms of the

sample size and sample technique. There may also be unreliability with respect to the accuracy of the data.

Methods of collection of data

Primary Data

1. Personal Investigation (interviews)
2. Oral Interview
3. Questionnaire and Surveys
4. Local Agencies
5. Face to face situation

Secondary Data

1. Published Sources
2. Office Records
3. Documents
4. Official Letters
5. Note Book
6. Rating Scales



Identification of Issues: EDUCATION, RESEARCH & DEVELOPMENT CENTRE FOR SOCIAL SCIENCES & HUMANITIES

It is very important to identify clearly the issues that are going to be assessed. Depending upon the availability of time, cost, manpower and tools, a frame work of issues to be covered need to be developed. In case of local area planning the following issues need to be considered.

1. Issues related to environmental conditions like environmental degradation, quality of human life etc.
2. Social issues like people's perception, literacy status, health hazards, incidence of crime etc.
3. Economic issues like employment, expenditure pattern, flow of goods and commodities etc.
4. Population study for agriculture, industry etc

5. Land use study for agriculture, industry etc.
6. Facilities and amenities available for social and economic development.
7. Problems related to growth of economy such as irrigation, means of transportation, availability of power etc.
8. Focal theme of planning like provision of basic amenities in slum areas, pollution control, clean environment in an industrial area.

Sampling method

Sample is small proportion of the population taken from the population to study the characteristics of the population. By observing the sample one can make inferences about the population from which it is taken.

Sampling unit is the basic unit to be sampled from the population which cannot be further subdivided for the purpose of sampling.

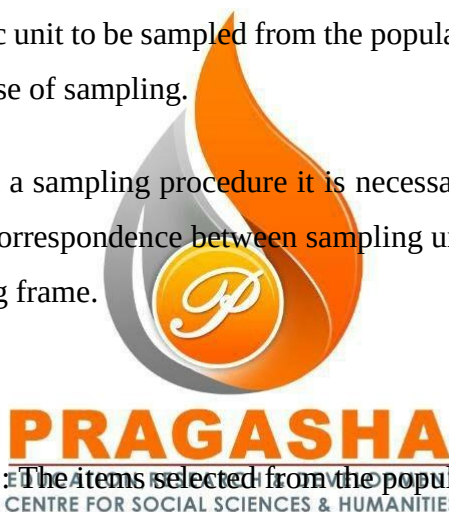
Sampling frame to adopt a sampling procedure it is necessary to prepare a list such that there exists, one to one correspondence between sampling units and numbers. Such a list or map is called sampling frame.

Sampling Distribution

(a) Systematic Sampling : The items selected from the population are chosen in a regular way. Such a procedure of sampling is called a systematic sampling. For example selection of samples in a multiple of 8(8th 16th, 24th etc.), 10 (10th, 20th, 30th etc.) or any other number so decided.

(b) Random Sampling: The selection of samples, in random sampling, depends upon the chance as universe presents homogenous conditions throughout. There are two types of random sampling.

(i) Simple Random Sampling: The procedure of sampling in which each unit of universe has equal chance of being included as the sample is known as simple random sampling. For example in a survey on consumer behavior each consumer has an equal chance for being selected as a sample.



(ii) **Stratified Random Sampling:** This type of sampling procedure is used when considerable heterogeneity is present in the distribution. The selection of samples in such a situation is based on the division of the universe of study into homogeneous subgroups or strata. Certain aspects of study present stratified character like social structure (having groups like general population, SC population and ST population); economic structure (primary, secondary, tertiary sector etc.) Random samples are selected from each sub group based on their relative significance in the universe.

Non-probability sampling:

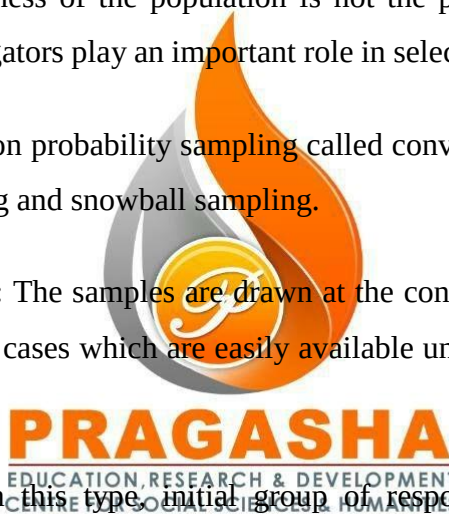
Non probability sampling is the sampling procedure in which samples are selected based on the subjective judgment of the researcher, rather than random selection. This is used when the representativeness of the population is not the prime issue. Convenience or judgments of the investigators play an important role in selecting the samples. In general, there are four types of non probability sampling called convenience sampling, judgment sampling, quota sampling and snowball sampling.

Convenience Sampling: The samples are drawn at the convenience of the investigator. The investigator pick up cases which are easily available units keeping the objectives in mind for the study.

Snowball Sampling: In this type, initial group of respondents are selected. Those respondents are requested to provide the names of additional respondents who belong to the target population of interest.

Judgement Sampling.

The investigator believes that in his opinion, some objects are the best representative of the population than others. It involves “hand picking” of sampling units. That is the interviewer uses his judgment in the selection of the sample that who should represent the population to serve the investigator’s purpose. It is usually used when a limited number of



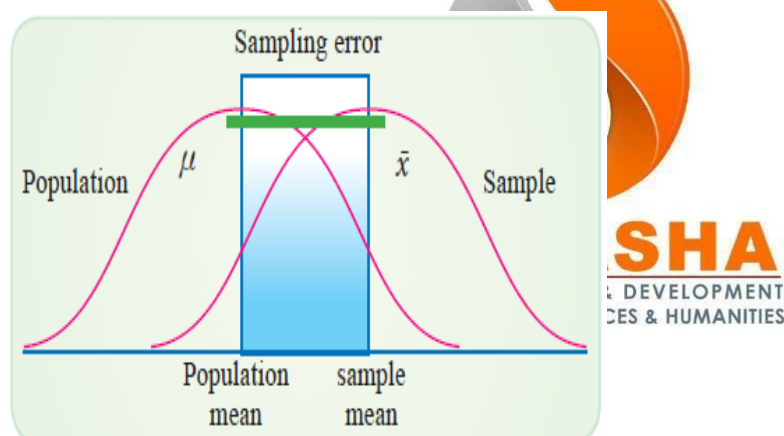
individuals possess the trait of interest. This type of sampling is also known as purposive sampling. This is useful when selecting specific people, specific events, specific prices of data, etc.

Quota Sampling

This is another non-probability sampling method. In this method, the population is divided into different groups and the interviewer assign quotas to each group. The selection of individuals from each group is based on the judgment of the interviewer. This type of sampling is called quota sampling.

Sampling and Non-Sampling Error

The purpose of sample is to study the population characteristics. The sample size is not equal to population size except in the case complete enumeration. Therefore, the statistical measurements like mean of the sample and mean of the population differ.



If $\bar{x}$ is the sample mean and μ is the population mean of the characteristic X then the sampling error is $\bar{x} - \mu$. The sampling error may be positive or negative or zero.

NON-SAMPLING ERROR

The non-sampling errors arise due to various causes right from the beginning stage when the survey is planned and designed to the final stage where the data are processed and analyzed. Non-sampling errors are more serious than the sampling errors because a sampling error can be minimized by taking a large sample. It is difficult to minimize non

sampling errors, even if a large sample is taken. The main sources of non-sampling errors are now described.

(i) Non-response: The errors due to non-response may occur due to omission or lapse on the part of the interviewer, or the refusal on the part of the respondents to questions or because of the non-availability of the individuals during the period of survey.

(ii) Errors in measurement: The measuring device may be biased or inaccurate. The respondent may not know the correct answer and may give imprecise answers. Common examples are questions on age, income, and events that happened in the past. The interviewer may also fail to record the responses correctly. Errors in measurement include errors in coding, editing, and tabulation.

Coverage errors: The coverage errors are classified as ‘under coverage errors’ and ‘over coverage errors’. Under-coverage errors occur in the following situations:

- The selected unit in the sampling frame is not interviewed by the investigator.
- The selected unit is incorrectly classified as ineligible for surveys
- The unit is omitted or skipped by the interviewer.

Similarly, over-coverage occurs under the following situations:

- The sampling frame covers ineligible units.
- The frame may contain the same unit more than once.

The errors cannot be ignored since the cumulative effect of these errors affect the objectives of the survey.

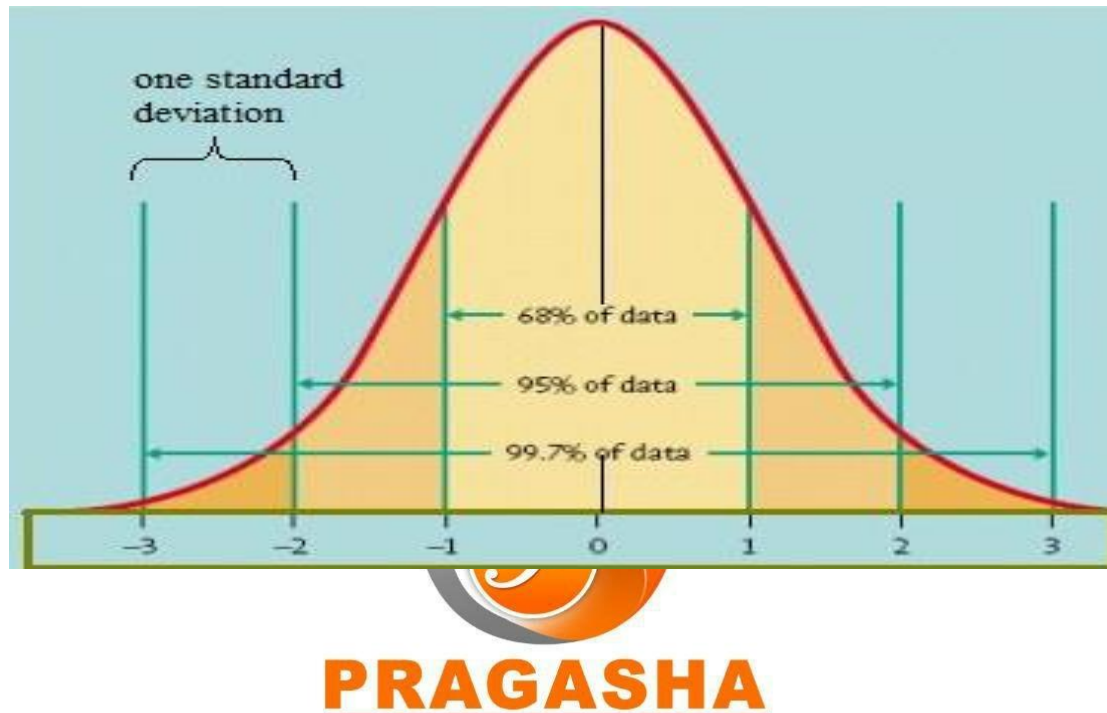
Normal Distribution

A normal distribution in a variate X with mean μ and variance σ^2 is a statistic distribution with probability density function

$$P(x) = \frac{1}{\sigma \sqrt{2\pi}} e^{-(x-\mu)^2 / (2\sigma^2)}$$

Properties

- The mean, mode and median are all equal.
- The curve is symmetric at the center (i.e. around the mean, μ).
- Exactly half of the values are to the left of center and exactly half the values are to the right.
- The total area under the curve is 1.



Hypothesis Testing

Hypothesis testing was introduced by [Ronald Fisher](#), [Jerzy Neyman](#), [Karl Pearson](#) and Pearson's son, [Egon Pearson](#). Hypothesis testing is a statistical method that is used in making statistical decisions using experimental data. Hypothesis Testing is basically an assumption that we make about the population parameter.

Key terms and concepts:

- **Null hypothesis:** Null hypothesis is a statistical hypothesis that assumes that the observation is due to a chance factor. Null hypothesis is denoted by; $H_0: \mu_1 = \mu_2$, which shows that there is no difference between the two population means.
- **Alternative hypothesis:** Contrary to the null hypothesis, the alternative hypothesis shows that observations are the result of a real effect.

- **Level of significance:** Refers to the degree of significance in which we accept or reject the null-hypothesis. 100% accuracy is not possible for accepting or rejecting a hypothesis, so we therefore select a level of significance that is usually 5%.
- **Type I error:** When we reject the null hypothesis, although that hypothesis was true. Type I error is denoted by alpha. In hypothesis testing, the normal curve that shows the critical region is called the alpha region.
- **Type II errors:** When we accept the null hypothesis but it is false. Type II errors are denoted by beta. In Hypothesis testing, the normal curve that shows the acceptance region is called the beta region.
- **Power:** Usually known as the probability of correctly accepting the null hypothesis. 1-beta is called power of the analysis.
- **One-tailed test:** When the given statistical hypothesis is one value like $H_0: \mu_1 = \mu_2$, it is called the one-tailed test.
- **Two-tailed test:** When the given statistics hypothesis assumes a less than or greater than value, it is called the two-tailed test.

Specific Tests:

- ANOVA.
- Chi Square Test for Normality
- F Test
- How to Run a Sign Test.
- T Test: one sample.
- T-Test: Two sample.
- Welch's ANOVA.
- Z-Test: one sample.
- Z Test: Two Proportion

ANALYSIS AND INTERPRETATION OF DATA

- Analysis and interpretation of the obtained data through Analysis of Co variance
- Factorial analysis and interpretation of the obtained data through Analysis of Covariance

- Analysis and interpretation of the obtained data of Experimental group through Analysis of Co variance

One Way Classification (CRD)

Sources of Variance	df	Sum of Square	Mean Square	F-Value	Table value	Significant level
Among	1	2229.07	2229.07	121.15	F _{0.01} = 6.90 F _{0.05} = 3.94	Significant at 0.01
Within	96	1766.31	18.40			
Total	97	3995.38	2247.47			

Two way Classification (RBD)

Three Way Classifications (LSD)



Time Series Analysis

Time series analysis is a [statistical technique](#) that deals with time series data, or trend analysis. Time series data means that data is in a series of particular time periods or intervals. The data is considered in three types:

Time series data: A set of observations on the values that a variable takes at different times.

Components of Time series

- **Secular Trend:** The variation of observations in a time series over a **long** period of time is known as Trends. Thus, a Trend won't bother about any short-term variations in the data. Example 1 . Increase in price Petrol 2. Gold rates. 3 Decrease in death rate
- **Cyclical Fluctuation:** The variation of observations in a time series occurring generally in business and economics where the rises and falls in the data are **not of fixed period** is known as Cyclic Variation. The duration of these cycles is more than a year. For Eg: Sensex Price
- **Seasonal Variations :** The variation of observations in a time series caused due to **regular or periodic** time variations is known as Seasonality. A repetitive pattern which can be predicted is termed as Seasonality. It also considers the short-term

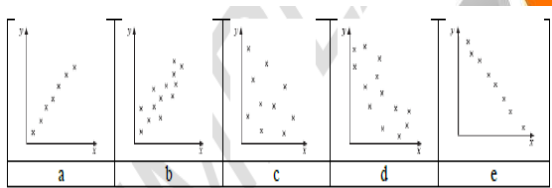
fluctuations in time. For Eg: 1. Travel during holidays 2. Density of mosquitoes in winter 3. Ice cream sale in summer

- **Irregular Variations:** The variation of observations in a time series which is unusual or unexpected is known as Irregular Variation. It is also termed as a Random Variation and is usually unpredictable. For Eg: 1. Strikes 2. Natural Disasters

Correlation and Regression

Correlation is a measure of association between two variables. The variables are not designated as dependent or independent. Correlation also provides a numerical measure of the linear or “straight-line” relationship between two continuous variables X and Y

Correlation is Positive or direct when the values increase together, and Correlation is Negative when one value decreases as the other increases, and so called • inverse or contrary correlation.



- Strong positive correlation between x and y. The points lie close to a straight line with y increasing as x increases
- Weak, positive correlation between x and y. The trend shown is that y increases as x increases but the points are not close to a straight line
- No correlation between x and y; the points are distributed randomly on the graph.
- Weak, negative correlation between x and y. The trend shown is that y decreases as x increases but the points do not lie close to a straight line
- Strong, negative correlation. The points lie close to a straight line, with y decreasing as x increases

The two most popular correlation coefficients are: Spearman's correlation coefficient rho and Pearson's product-moment correlation coefficient. When calculating a correlation coefficient for ordinal data, select Spearman's technique. For interval or ratio-type data, use Pearson's technique

The value of a correlation coefficient can vary from minus one to plus one. A minus one indicates a perfect negative correlation, while a plus one indicates a perfect positive correlation. A correlation of zero means there is no relationship between the two variables. When there is a negative correlation between two variables, as the value of one variable increases, the value of the other variable decreases, and vice versa.

The standard error of a correlation coefficient is used to determine the confidence intervals around a true correlation of zero. If your correlation coefficient falls outside of this range, then it is significantly different from zero. The standard error can be calculated for interval or ratio-type data (i.e., only for Pearson's product-moment correlation)

The significance (probability) of the correlation coefficient is determined from the t-statistic. The probability of the t-statistic indicates whether the observed correlation coefficient occurred by chance if the true correlation is zero. In other words, it asks if the correlation is significantly different than zero. When the t-statistic is calculated for Spearman's rank-difference correlation coefficient, there must be at least 30 cases before the t-distribution can be used to determine the probability. If there are fewer than 30 cases, you must refer to a special table to find the probability of the correlation coefficient.

Pearson r correlation: Pearson correlation is widely used in statistics to measure the degree of the relationship between linear related variables. For example, in the stock market, if we want to measure how two commodities are related to each other, Pearson correlation is used to measure the degree of relationship between the two commodities. The following formula is used to calculate the Pearson correlation coefficient

Kendall's Tau rank correlation: Kendall rank correlation is a non-parametric test that measures the strength of dependence between two variables. If we consider two samples, x and y , where each sample size is n , we know that the total number of pairings with x y is $n(n-1)/2$.

Spearman rank correlation: Spearman rank correlation is a non-parametric test that is used to measure the degree of association between two variables. It was developed by Spearman, thus it is called the Spearman rank correlation. Spearman rank correlation test does not assume any assumptions about the distribution of the data and is the appropriate

correlation analysis when the variables are measured on a scale that is at least ordinal. The following formula is used to calculate the Spearman rank correlation coefficient:

$$r = 1 - 6 \sum \frac{d^2}{n(n^2 - 1)}$$

Regression

Simple regression is used to examine the relationship between one dependent and one independent variable. After performing an analysis, the regression statistics can be used to predict the dependent variable when the independent variable is known

The regression line (known as the least squares line) is a plot of the expected value of the dependent variable for all values of the independent variable. Technically, it is the line that "minimizes the squared residuals". The regression line is the one that best fits the data on a scatterplot.

Using the regression equation, the dependent variable may be predicted from the independent variable. The slope of the regression line (b) is defined as the rise divided by the run. The y intercept (a) is the point on the y axis where the regression line would intercept the y axis. The slope and y intercept are incorporated into the regression equation. The intercept is usually called the constant, and the slope is referred to as the coefficient. Since the regression model is usually not a perfect predictor, there is also an error term in the equation

The standard error of the estimate for regression measures the amount of variability in the points around the regression line. It is the standard deviation of the data points as they are distributed around the regression line. The standard error of the estimate can be used to develop confidence intervals around a prediction.

The regression model is based on the following assumptions.

- The relationship between independent variable and dependent is linear
- The expected value of the error term is zero
- The variance of the error term is constant for all the values of the independent variable

- the assumption of homoscedasticity.
- There is no autocorrelation.
- The independent variable is uncorrelated with the error term
- The error term is normally distributed.
- On an average difference between the observed value (y_i) and the predicted value ($\hat{y}_i$) is zero.
- On an average the estimated values of errors and values of independent variables are not related to each other.
- The squared differences between the observed value and the predicted value are similar.
- There is some variation in independent variable. If there are more than one variable in the equation, then two variables should not be perfectly correlated.

Statistical usage

Stata, SPSS,



DATA PROCESSING

Data processing may involve various processes, including:

- Validation – Ensuring that supplied data is correct and relevant.
- Sorting – "arranging items in some sequence and/or in different sets."
- Summarization – reducing detail data to its main points.
- Aggregation – combining multiple pieces of data.
- Analysis – the "collection, organization, analysis, interpretation and presentation of data."
- Reporting – list detail or summary data or computed information.
- Classification – separation of data into various categories.

OR

Data processing can be defined by the following steps

- Data capture, or data collection.

- [Data storage.](#)
- Data conversion (changing to a usable or uniform format).
- Data cleaning and error removal.
- Data validation (checking the conversion and cleaning).
- Data separation and sorting (drawing patterns, relationships, and creating subsets).
- Data summarization and aggregation (combining subsets in different groupings for more information).
- Data presentation and reporting.

APPLICATIONS OF COMPUTER IN ACCOUNTING

A computer is an electronic device, which is capable of performing a variety of operations as directed by a set of instructions. This set of instructions is called a computer programme. A computer system is a combination of six elements:

1. Hardware : Hardware of computer consists of physical components such as keyboard, mouse, monitor and processor. These are electronic and electromechanical components.
2. Software : A set(s) of programmes, which is used to work with such hardware is called its software. A coded set of instructions stored in the form of circuits is called firmware
3. People: People interacting with the computers are also called live-ware of the computer system. They constitute the most important part of the computer system
 - a. System Analysts are the people who design data processing systems.
 - b. Programmers are the people who write programmes to implement the data processing system design.
 - c. Operators are the people who participate in operating the computers. People who respond to the procedures instituted for executing the computer programmes are also a part of live-ware.
4. Procedures: The procedure means a series of operations in a certain order or manner to achieve desired results.
5. Data:
6. Connectivity:

Computerized Inventory Control System

Definition: A Computerized Inventory Control System is the integration of sub-functions involved in the management of inventory into a single cohesive system. It is software installed on the computer systems that enables a firm to keep a check on the inventory levels by performing the automatic counting of inventories, recording withdrawals and revising the stock balance.

It is very difficult for any firm to maintain a large stock of inventories, and therefore, many firms have adopted the JIT system in terms of Minimum and Maximum limit for the stock. There is an inbuilt system for placing orders in computer systems that automatically generates a PO to the supplier when the minimum level of the stock or the reorder point is reached.

The benefits of a computerized inventory control system can be derived, when the business integrates its inventory control system with the other systems such as accounting and sales, that helps in better control of inventory levels.

In practice, when the inventory level reaches to its minimum point, the system automatically generates a purchase order, which is sent to the supplier electronically. Also, the other copy of the PO is sent to the accounting department. Once the material is received from the supplier, an inventory gets updated on the system and at the same time, the notification is sent to the accounting department, which is used against the supplier's Invoice and the PO copy.

Thus, a computerized inventory control system has made a life of both the manufacturer and the big retailer easy, who can manage their inventories electronically without wasting much time on the manual tracking system. Also, all the documents, such as purchase order, Invoice, account statement gets automatically generated with a use of computerized inventory control system.

But however, too much reliance on the technology may be problematic in the situations of power failure and lost internet connectivity, as it may bring a system to a standstill. Also, the accuracy of inventory items inserted in the system depends on the data entry

made by the person. Thus, a proper entry should be made to obtain the correct inventory levels.

Computer Application in Marketing

Marketing in general has always existed, online marketing does so thanks to computers. Just like the traditional flyers and newspapers were personally distributed through people, ads and promotional campaigns are now reaching you thanks to social media channels, e-mail newsletters, messages and many other digital ads conveniently located in the websites you frequent.

The internet also opened the doors to online shopping, through computers you can now buy online and get your goods delivered to your home.

Computers have become a vessel in which marketers do their thing: promote, measure and evolve marketing techniques online.

Apart from that, computers have become a must-have tool for designers and other people that work in marketing.

Creating a product or service that fulfills a consumer need is necessary for a small business to achieve success, but a strong concept alone is not enough to ensure profitability. Small businesses have to convince consumers to try a new product and find ways to deliver those products to consumers to be successful. Computers can be a powerful tool for assisting small companies in many aspects of marketing new products and services.

Marketing professionals use computer technology to plan, manage and monitor campaigns.

By analyzing and manipulating data on computers, they can increase the precision of marketing campaigns, personalize customer and prospect communications, and improve customer relationship management.



Components of a computer

1. Input
2. CPU (control Processing Unit)
3. Output

IMPORTANT GLOSSARY

1. **Statistics:** A type of mathematical analysis involving the use of quantified representations, models and summaries for a given set of empirical data or real world observations. Statistical analysis involves the process of collecting and analyzing data and then summarizing the data into a numerical form.
2. **Statistical enquiry:** Statistical enquiry refers to a process of collection of data and presentation of the collected data in meaningful ways.
3. **Analytical Statistics:** The branch of statistics that is used in analyzing the data in terms of drawing meaningful conclusions, comparing two sets of data etc.
4. **Inductive Statistics:** The branch of statistics that deals with generalizations, predictions, estimations, and decisions from data initially presented.
5. **Inferential Statistics:** The branch of statistics that draws conclusions that extend beyond the immediate data alone. Applied Statistics. The branch of statistics that extends to practical application of statistics, as opposed to the study of its theoretical basis.
6. **Descriptive Statistics** Any calculation which attempts to provide a concise summary of the information content of data that is collection,
7. **Hypothesis:** A tentative explanation for an observation, phenomenon, or scientific problem that can be tested by further investigation.
8. **Data:** Data collected in original form for statistical enquiry.
9. **Census:** The collection of data from every element in a population or universe or arena of statistical enquiry.
10. **Sample:** The collection of data from subgroup or subset of the population.
11. **Discrete Variable:** Variables (data) which assume a finite or countable number of possible values, usually obtained by counting.
12. **Frequency:** The number of times a certain value or class of values occurs.
13. **Cumulative Frequency:** The running total of the frequencies at each class interval level.

14. **Frequency Distribution:** The organization of raw data in table form with classes and frequencies.
15. **Class Limits:** Separate one class in a grouped frequency distribution from another. The limits could actually appear in the data and have gaps between the upper limit of one class and the lower limit of the next.
16. **Class Width:** The difference between the upper and lower boundaries of any class.
17. **Class Boundary:** It is the process of making the distribution continuous. The lower class boundary is found by subtracting 0.5 units from the lower class limit and the upper class boundary is found by adding 0.5 units to the upper class limit.
18. **Class Mark:** The middle point of the class. It is found by adding the upper and lower limits and dividing by two. It can also be found by adding the upper and lower boundaries and dividing by two.
19. **Histogram:** A graph which displays the data by using vertical bars of various heights to represent frequencies. The horizontal axis can either be the class boundaries, the class marks, or the class limits.
20. **Frequency Polygon:** A line graph. The frequency is placed along the vertical axis and the class midpoints are placed along the horizontal axis. These points are connected with straight lines.
21. **Frequency Curve:** A smooth frequency polygon.
22. **Cross Tabulation:** Cross tabulation is a useful data analysis technique. Data referring to a particular can be broken down by reference to one or more other variables through successive cross tabulations.
23. **Ogive:** A frequency polygon of the cumulative frequency or the relative cumulative frequency.
24. **Pie Chart:** Graphical depiction of data as slices of a pie. The frequency determines the size of the slice. The number of degrees in any slice is the relative frequency times 360 degrees.
25. **Scatter Diagram:** To find out the nature of relationship we prepare a dot chart, this dot chart is known as scatter diagram.
26. **Mean:** Sum of all the values divided by the number of values.
27. **Median:** The midpoint of the data after being ranked (sorted in ascending order). There are as many numbers below the median as above the median.
28. **Mode:** The most frequent number. There may not be a mode; there may be one mode; or there may be many modes.

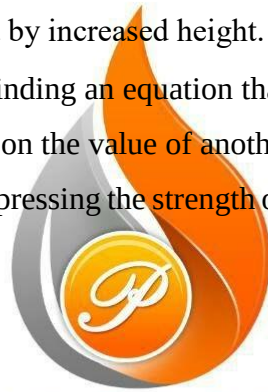
29. **Weighted Mean:** The mean when each value is multiplied by its weight and summed. This sum is divided by the total of the weights.
30. **Mean Deviation:** It is the average difference between the items in a distribution and the mean of that series.
31. **Standard Deviation:** A measure of dispersion calculated as the square root of the variance.
32. **Range:** It is defined as the difference between the value of the largest item and the value of the smallest item.
33. **Coefficient of Variation:** This measure is used to compare variability or homogeneity or stability or uniformity or **consistency** of two or more sets of data.
34. **Bi-variate Analysis:** It is related to the analysis of two variables for the purpose of determining the empirical relationship between them.
35. **Covariance:** Covariance indicates how two variables are related.
36. **Coefficient of Correlation:** Correlation analysis deals with the association between two or more variables.

Common Statistical Tests

Statistical tests are utilized in determining the probabilities of relationships in a study. Some of the tests that doctors of chiropractic (DCs) commonly encounter while reading scientific articles are **t-tests**, **chi-square** (non-parametric comparisons), **ANOVA**, **contingency tables**, **Pearson's correlation and regression**.

- The **t-test** (AKA Student's *t*-test) assesses whether the means of two groups are *statistically* different from each other. However, the results of a *t*-test aren't entirely black-and-white. The results actually indicate that the means are probably different, or if the study fails to show an effect, that the means are probably the same.
- **ANOVA** (analysis of variance) is used to compare means when more than two groups are involved. Intuitively, one would think that a *t*-test could be simply be repeated for as many groups as are involved in the study, however this leads to an increased possibility of committing a **type I error** (rejecting a true null hypothesis).
- The **chi-square test** is used with non-parametric data, which includes nominal and ordinal data, but may also include interval and ratio data from a population that does not conform to a normal distribution.

- **Contingency tables** are frequently presented in the literature and are simply tables that represent relationships between categorical or **binomial** (when there are exactly two mutually exclusive outcomes) variables. An example would be the relationship between being adjusted (yes or no) and having a headache (yes or no).
- **Pearson's correlation** (or simply correlation) is a number (r = **correlation coefficient**) that describes the strength of the relationship between two variables. Relationships can be positive or negative and vary from -1 to +1. A strong positive relationship would be near +1, no relationship would be 0, and a strong negative relationship near -1. An example is the relationship between height and weight, which is strongly positive. Taller people tend to be heavier and shorter people tend to be lighter. R^2 is the proportion of one variable that can be explained by the other one. Consequently, we can say, in the case of height and weight, 75% of the increase in a person's weight is explained by increased height.
- **Regression** is a method of finding an equation that allows for prediction of the value of one variable that is based on the value of another variable. Regression is similar to correlation, but instead of expressing the strength of relationship, a predictive equation is calculated.



The Tests:

t-test:



A *t*-test is used to determine whether the means of two groups are statistically different from each other. If the means are statistically different, then the null hypothesis (H_0) is rejected and the alternate or research hypothesis (H_1) is accepted. The *t*-test can also be carried out on a single sample by comparing a study's group mean with a known value. For instance, a study involving cervical ROM could compare the resulting mean with a known normal value for cervical flexion.

The *t*-test produces a test statistic, termed the *t*-score or *t*-ratio. This value is used to find the corresponding *p*-value by means of a *t*-table (see below). The *t*-ratio is comprised of the difference of the means being tested divided by the variability of the data, which is represented by something called the standard error of the difference (you don't have to know this term or the following equation). See equation below:

$$t = \frac{\bar{X}_1 - \bar{X}_2}{S_{\bar{X}_1 - \bar{X}_2}}$$

The following partial reproduction of a *t*-table is used to determine the probability associated with a given *t*-score, taking into consideration the number of subjects in the groups under study (termed degrees of freedom [df], which equals the number of subjects in each group minus 1).

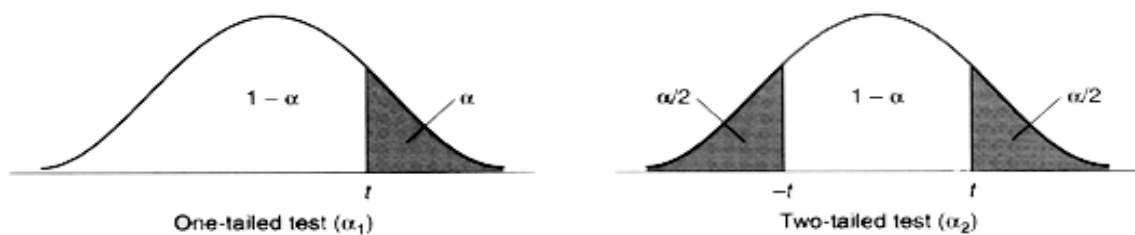


TABLE A.2 CRITICAL VALUES OF *t*

<i>df</i>	α_1	.10	.05	.025	.01	.005	.0005
	α_2	.20	.10	.05	.02	.01	.001
1		3.078	6.314	12.706	31.821	63.657	636.619
2		1.886	2.920	4.303	6.965	9.925	31.598
3		1.638	2.353	3.182	4.541	5.841	12.924
4		1.533	2.132	2.776	3.747	4.604	8.610
5		1.476	2.015	2.571	3.365	4.032	6.859
6		1.440	1.943	2.447	3.143	3.707	5.959
7		1.415	1.895	2.365	2.998	3.499	5.405
8		1.397	1.860	2.306	2.896	3.355	5.041
9		1.383	1.833	2.262	2.821	3.250	4.781
10		1.372	1.812	2.228	2.764	3.169	4.587
11		1.363	1.796	2.201	2.718	3.106	4.437
12		1.356	1.782	2.179	2.681	3.055	4.318
13		1.350	1.771	2.160	2.650	3.012	4.221
14		1.345	1.761	2.145	2.624	2.977	4.140
15		1.341	1.753	2.131	2.602	2.947	4.073

Directional vs. Nondirectional hypotheses: In a nondirectional hypothesis, we would be interested in knowing if the scores differ, but (before the analysis) have not made any statements about whether the score will be higher or lower. The hypothesis would be directional if we had stated that the scores of one group would be higher than the other group. With a nondirectional test alpha is split between the two tails of the distribution and with a directional test alpha is all in one tail. As you will see, it is much easier to reach statistical significance with a directional (one-tail) test than a nondirectional test. However, in order to make a statement that one set of scores will be higher than the other; the other direction must be of no interest. A statement we can rarely make in chiropractic

research because it is typically possible that the test could go either way. This topic is somewhat controversial.

Assumptions: There are several assumptions that must be met in order to legitimately perform a *t*-test:

- Samples must be randomly drawn from the parent population
- Data in each group must have a normal distribution
- The variances for each of the groups must be equal (otherwise the *t*-test for unequal variances should be used)
- The samples must be independent. That is, subjects included in the second sample don't depend on those who are included in the first sample (and vice versa)

There are statistical tests that can determine whether or not the data in a given study are normal and whether variances are equal. Most statistical software packages, including Microsoft Excel, are capable of running these tests.

Another form of the *t*-test, called the **paired *t*-test**, is carried out on dependant samples. This test is used to compare means on the same or related subjects over time or in differing circumstances. For instance, repeated measures studies use the paired *t*-test to compare measurements obtained initially and then at follow-up evaluations. Subjects are often tested in a before-after situation (across time, with some intervention occurring such as chiropractic adjustments), or subjects are paired such as with twins, or with subject as alike as possible. The assumptions for this test are that the observed data are from the same subject or from a matched subject and are drawn from a population with a normal distribution.

Steps involved in the *t*-test

- After gathering the data, calculate the means and standard deviations.
- Calculate the *t*-ratio.
- Look up the resulting *t*-statistic in a *t*-table.
- If the probability of *t* is less than 0.05 (which is the typical value for alpha), it is significant.
- Then conclude that the groups are different.

Remember:

- Big t -value → Small p -value → SIGNIFICANCE

	t -test Summary	
Number of subjects	Assumptions	Results
The more subjects you have-the easier it is to find significance . You will have more power to find differences. The number of subjects determines degree of freedom: $df = N_1 + N_2 - 2$ for Independent groups and $N_{pairs} - 1$ for repeated or matched groups	The two groups should be normal in shape. They should have the same standard deviation . If they are not, the chance of a Type I error increases (incorrectly saying there is a difference between the groups).	A large t-value and a small p-value are needed to reach statistical significance.

ANOVA:

Used when comparing means involving more than two groups.

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To carry out ANOVA, the mean and standard deviation for each of the groups involved in the study must be calculated. The analysis of variance will then tell us three things:

- Whether there are any significant differences of means among all of the groups. Provided by the **F -ratio**.
- Whether any of the specific groups differ from each other. There are more than one possible pairs of groups when you have more than two. This is provided by using Comparison Techniques.
- Whether the differences are relatively big or small. Measures of Explained Variance will tell us this.

The F-ratio is similar to the t -ratio, however, the F-ratio compares the variance between the groups with the variance within the groups.

$$F = \frac{\text{variance between groups}}{\text{variance within groups}}$$

The within-group variance is related to sampling error, subject differences, etc. It's like the variance we previously discussed. Between-group variance is due to the differences between the groups. If the means of the groups differ significantly, then there will be an associated between groups variance that is high. If the F-ratio is **small**, then groups are probably **not significantly different** from each other. However, if it is **big**, then some (two or more) **might be significantly different** from each other.

We cannot simply calculate repetitive *t*-tests for each group comparison when more than 2 groups are involved because the Type 1 error rate (saying there is a difference between means when there isn't one) will dramatically increase. While we're on the subject, Type 2 error is the opposite, saying there isn't a difference between means when there really is one. The F-Ratio avoids this problem because it is an overall test. A significant F means that there are some differences between some of the groups, but at that point, it is not known which particular groups differ. That's why Comparison Techniques are used, which compare the individual group pairs.

F-tables are available that are similar to *t*-tables, but are specific for the F-ratio. The F-table is consulted to determine if there is a significant difference among the means. Again, computer programs are available to do all this work for you. That's one reason formulas and associated calculations have not been included.

Chi-square

The chi-square test allows us to test hypotheses using nominal or categorical data (i.e., classifications or categories). What chi-square does is test whether one set of proportions is different from another by comparing frequencies.

Chi-square goodness of fit:

Chi-square's purpose is to determine how a set of proportions that are thought to be true (expected) compare with a set of data that have been observed (observed). The Chi-square formula compares the difference between the observed and expected frequencies, divided by the expected frequencies.

$$X^2 = \frac{\sum(O - E)^2}{E}$$

(Where O = the observed frequency and E = the expected frequency)

The chi-square statistic is evaluated for statistical significance using a chi-square table, with df equal to the number of categories minus 1. If the tabled value is exceeded, then the test is significant (just like in the *t*-test and F-test). This particular chi-square test is sometimes called the goodness of fit test because it tests whether “Observed” frequencies fit against the “Expected” frequencies.

Chi-square Test of Independence:

This test is done to see whether the breakdown of proportions or frequencies for one category differ significantly from that of another category. The **Chi-square Test of Independence** uses a contingency table (also known as a cross-tabulation table) that lays out the corresponding variables.

The expected values are calculated as follows:

$$\text{Expected}(E) = \frac{\text{Row Total} \times \text{Column Total}}{\text{Grand Total}}$$


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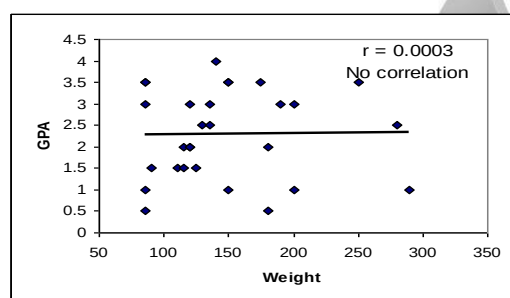
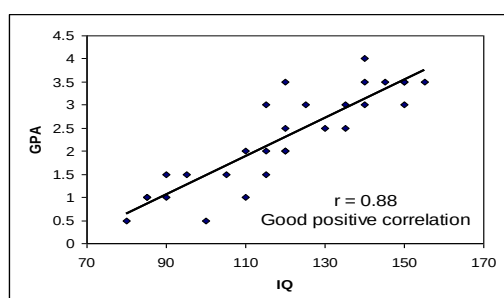
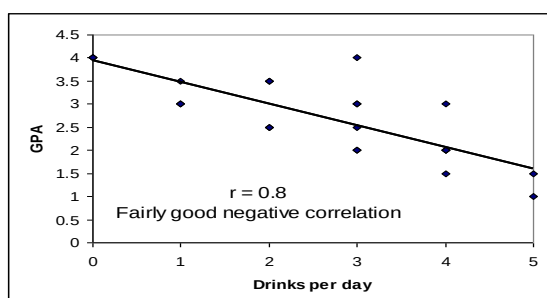
Pearson's correlation and Regression

The purpose of a **Correlation Coefficient** (*r*) is to show the strength of a linear relationship between two variables. In other words, if you have two sets of scores: Are they related? If so, how strong is the relationship? Does one score predict the other? For example, the relationship between patient age and the number of visits they received during a study can be examined as follows:

This is a computer generated **regression** line that best predicts where a visit should appear on the plot for a given age. The regression line is an average of all the graphed data points.

Values for *r* range from -1 to +1. A value of zero (0.0) specifies no relationship between the variables, while values approaching -1 or +1 indicate predicative relationships. ±1 is

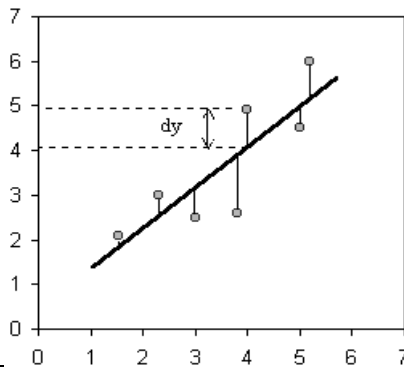
the strongest possible relationship, with the sign indicating the direction of relationship. Following are examples of positive correlation, no correlation, and negative correlation:



R^2 can be calculated by squaring the correlation coefficient. This provides the proportion of explained variance; in other words, how much of the variation of the Y variable can be explained by variation of the X variable. In the previous example of age and visits $r = -0.897$ and R^2 (the proportion of explained variance) = 0.805. R^2 could be multiplied by 100 to produce the percent explained variance and we could say “80% of the variation of visits can be explained by age.”

A **regression line** is calculated mathematically to represent a straight line represented by the formula of a line $Y=a+bx$, where a is the *y-intercept* and b is the slope (similar to the equation of a sloped line you may remember from algebra $Y=mX+b$). The line is fitted to a set of data by minimizing the sum of squared deviations (dy) of the observed data points from the line. Conceptually, it’s almost like finding the average of these deviations, but

involving fairly complicated math. Again, let's leave it up to the computer to calculate as I did up above.



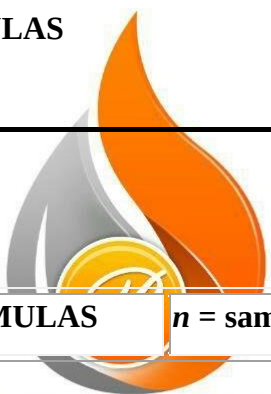
Statistical Test Decision Table (from Intuitive Biostatistics by Harvey Motulsky)

	Type of Data		
Goal	Measurement from Gaussian Population*	Rank, Score, Measurement from Non-Gaussian Population	Binomial (Two Possible Outcomes)
Describe one group	Mean, SD	Median, interquartile range	Proportion
Compare one group to a hypothetical value	One-sample <i>t</i> test	Wilcoxon test	Chi-square or Binomial test
Compare two unpaired groups	Unpaired <i>t</i> test	Mann-Whitney test	Fisher's test (chi-square for large samples)
Compare two paired groups	Paired <i>t</i> test	Wilcoxon test	McNemar's test
Compare three or more unmatched groups	One-way ANOVA	Kruskal-Wallis test	Chi-square test
Compare three or more matched groups	Repeated-measures ANOVA	Friedman test	Cochran Q
Quantify association between two variables	Pearson correlation	Spearman correlation	Contingency coefficients

Predict value from another measured variable	Simple line regression or Nonlinear regression	Nonparametric regression	Simple logistic regression
Predict value from several measured or binomial variables	Multiple line regression or Multiple nonlinear regression		Multiple logistic regression

* Gaussian Population = normally distributed population

SOME STATISTICS FORMULAS

	
FREQUENTLY USED FORMULAS	n = sample size; N = population size
Sample mean $\bar{x} = \frac{\sum x}{n}$	
Population mean $\mu = \frac{\sum x}{N}$	
Sample standard deviation $s = \sqrt{\frac{\sum (x - \bar{x})^2}{n - 1}}$ $s = \sqrt{\frac{SS_x}{n - 1}} \text{ where } SS_x = \sum x^2 - \frac{(\sum x)^2}{n}$	

Population standard deviation

$$\sigma = \sqrt{\frac{\sum (x - \mu)^2}{N}}$$

Sample mean for a frequency distribution

$$\bar{x} = \frac{\sum xf}{n}$$

Sample standard deviation for a frequency distribution

$$s = \sqrt{\frac{\sum (x - \bar{x})^2 f}{n - 1}}$$

Sample coefficient of variation

$$CV = \frac{s}{\bar{x}}$$

Range = Largest data value - smallest data value

Standard z value

$$z = \frac{x - \mu}{\sigma}$$

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Original x value

$$x = \mu + z\sigma$$

Central limit theorem

$$z = \frac{\bar{x} - \mu}{\sigma / \sqrt{n}}, \quad n \geq 30$$

PROBABILITY FORMULAS**Probability of an event A**

$$P(A) = \frac{f}{n}$$

where f = frequency of occurrence of event
 n = sample size

Probability of the complement of event A

$$P(\text{not } A) = 1 - P(A)$$

Multiplication rule for independent events

$$P(A \text{ and } B) = P(A) \cdot P(B)$$

General multiplication rules

$$P(A \text{ and } B) = P(A) \cdot P(B \text{ given } A)$$

$$P(A \text{ and } B) = P(B) \cdot P(A \text{ given } B)$$

Addition rule for mutually exclusive events

$$P(A \text{ or } B) = P(A) + P(B)$$

General addition rule

$$P(A \text{ or } B) = P(A) + P(B) - P(A \text{ and } B)$$



Permutation rule

$$P_{n,r} = \frac{n!}{(n-r)!}$$

Combination rule

$$C_{n,r} = \frac{n!}{r!(n-r)!}$$

Mean of a discrete probability distribution

$$\mu = \sum xP(x)$$

Standard deviation of a discrete probability distribution

$\sigma = \sqrt{\sum (x - \mu)^2 P(x)}$	
BINOMIAL DISTRIBUTION FORMULAS	where r = number of successes p = probability of success; $q = 1 - p$
Formula for a binomial probability distribution	
$P(r) = \frac{n!}{r!(n-r)!} p^r q^{n-r}$	
Mean for a binomial distribution	
$\mu = np$	
Standard deviation for a binomial distribution	
$\sigma = \sqrt{npq}$	
CONFIDENCE INTERVALS	
Confidence interval for a mean (large samples)	
$\bar{x} - z_c \frac{\sigma}{\sqrt{n}} < \mu < \bar{x} + z_c \frac{\sigma}{\sqrt{n}}$	
Confidence interval for a mean (Small samples)	
$\bar{x} - t_c \frac{s}{\sqrt{n}} < \mu < \bar{x} + t_c \frac{s}{\sqrt{n}}$	
Confidence interval for a proportion (where $np > 5$ and $nq > 5$)	
$\frac{r}{n} - z_c \sqrt{\frac{\frac{r}{n} \left(1 - \frac{r}{n}\right)}{n}} < p < \frac{r}{n} + z_c \sqrt{\frac{\frac{r}{n} \left(1 - \frac{r}{n}\right)}{n}}$	
SAMPLE SIZE	
Sample size for estimating means	
$n = \left(\frac{z_c \sigma}{E} \right)^2$	

Sample size for estimating proportions

$$n = p(1-p) \left(\frac{z_c}{E} \right)^2 \text{ with preliminary estimate for } p$$

$$n = \frac{1}{4} \left(\frac{z_c}{E} \right)^2 \text{ with no preliminary estimate for } p$$

REGRESSION AND CORRELATION

In all these formulas

$$SS_x = \sum x^2 - \frac{(\sum x)^2}{n}$$

$$SS_y = \sum y^2 - \frac{(\sum y)^2}{n}$$

$$SS_{xy} = \sum xy - \frac{(\sum x)(\sum y)}{n}$$

Least squares line

$$y = a + bx \text{ where } b = \frac{SS_{xy}}{SS_x} \text{ and } a = \bar{y} - b\bar{x}$$

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Standard error of estimate

$$S_e = \sqrt{\frac{SS_y - bSS_{xy}}{n-2}} \text{ where } b = \frac{SS_{xy}}{SS_x}$$

Pearson product-moment correlation coefficient

$$r = \frac{SS_{xy}}{\sqrt{SS_x SS_y}}$$

Coefficient of determination

$$r^2$$

Confidence interval for y

$y_p - E < y < y_p + E$ where y_p is the predicted y value for x

$$E = t_e S_e \sqrt{1 + \frac{1}{n} + \frac{(x - \bar{x})^2}{SS_x}}$$

Spearman Rank correlation coefficient

$$r_s = 1 - \frac{6(\sum d^2)}{n(n^2 - 1)}$$



Unit – 5: Business Management

- ✓ Principle of Management
- ✓ Planning - Objective, Strategic, Planning Process, Decision Making
- ✓ Organising, Organisational Structure, Formal and Informal Organisation, Organisational Culture
- ✓ Staffing
- ✓ Leading: Motivation, Leadership, Committees, Communication
- ✓ Controlling
- ✓ Corporate Governance and Business Ethics

Business Management

SCHOOLS OF MANAGEMENT THOUGHT

Four Basic Tenets of Capitalism - Described in *The Wealth of Nations*, Adam Smith, 1776.

- The laws of supply and demand will ensure the best use of society's resources
- Everyone has the right to accumulate wealth
- Everyone has the right to own property
- Division of labor yields gains in productivity

The Four Major Schools of Management Thought

- Classical
- Behavioral
- Modern
- Systematic

The Classical School of Management Thought

Workers viewed as 'machines', ie, as a smaller machine inside the big factory machine, as a "cog in the works."

- Advocates hierarchical authority
- Advocates division of labor (into simple a/o unskilled tasks)
- Strongly associated with scientific management

Scientific Management, Fredrick Taylor, 1911

Taylor is called "the father of scientific management" - focus on labor productivity and efficiency.

General Principles of Scientific Management

- There is one best way to perform a task
- Selection and training of workers should be scientific.
- Incentives should be provided for workers to use the "one best way"
- Managers and labor share work and responsibility.

Three Assumptions Underlying the General Principles of Scientific Management

- Employers and employees have a shared goal in economic gain. Counterexamples: "downsizing," minimizing wages
- Man is rational and economically motivated - Counterexamples: romance, auto purchasing, loyalty
- For every person, there is a job for which he is ideally suited.
- Associated with 'the quantitative (or decisional) approach'

The Behavioral School of Management Thought - also called the 'human relations movement'

- Views workers as 'people' and embraces the use of sociological & psychological techniques-

- Individuals who, while conducting research in scientific management, found evidence to support the humanization of worker conditions

Elton Mayo - The Hawthorne studies and the "Hawthorne effect"

- Work is a group activity.
- The social world of the adult is primarily patterned about work activity.
- The need for recognition, security and sense of belonging is more important in determining workers' morale and productivity than the physical conditions under which he works.
- A complaint is not necessarily an objective recital of facts; it is commonly a symptom manifesting disturbance of an individual's status position.
- The worker is a person whose attitudes and effectiveness are conditioned by social demands from both inside and outside the work area.
- Informal groups within the work area exercise strong social controls over the work habits and attitudes of the individual worker.
- The change from an established society in the home to an adaptive society in the work area resulting from the use of new techniques tends to continually disrupt the social organization of a work area plant and industry generally.
- Group collaboration does not occur by accident; it must be planned and developed. If group collaboration is achieved, then the human relations within a work area may reach a cohesion which resists the disrupting effects of adaptive society.

Douglas McGregor

'Theory X' Perspective of Management

- Workers are 'bad'
- People have little ambition at work
- People dislike work, and so must be threatened a/o forced to work
- People seek to fulfill lower-order needs through work
- People prefer formal direction in the workplace

- Theory x is more 'classical' in nature

'Theory Y' Perspective of Management

- Workers are 'good'
- People aspire to responsibility and self-control at work
- People prefer to work
- People seek to fulfill higher-order needs through work
- People prefer informal control mechanisms in the workplace
- Theory y is more 'behavioral' in nature

Henri Fayol - General Principles of Management

Some principles are more '**Classical**' in nature

- Division of work (labor)
- Authority and responsibility
- Discipline
- Unity of command, direction
- Centralization
- Scalar chain (eg, "top-down" authority)
- Order



Some principles are more '**Behavioral**' in nature

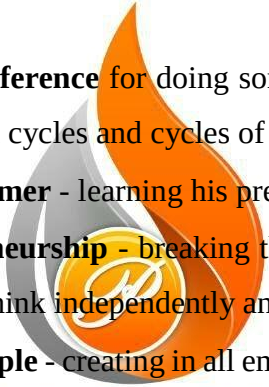
- Equity
- Worker tenure
- Initiative
- Esprit de corps
- 'Fair' remuneration

- Contained in *General and Industrial Management*, 1916
- Fayol's functional definition of management - quoted in *general and industrial management*, Henri Fayol, 1916) - "to forecast and plan, to organize, to command, to coordinate and to control")

The Modern School of Management Thought - Forward and popular thinking, for the most part by non-academics

- Tom Peters - *In Search of Excellence: Lessons from America's Best-Run Companies*, 1982. (Coauthored with Bob Waterman, Jr.)

The Eight Attributes of Excellence

- 
- **A bias for action -- a preference** for doing something - ANYTHING - rather than sending a question through cycles and cycles of analyses and committee reports
 - **Staying close to the customer** - learning his preferences and catering to them
 - **Autonomy and entrepreneurship** - breaking the corporation into small companies and encouraging them to think independently and competitively
 - **Productivity through people** - creating in all employees the awareness that their best efforts are essential and they will share in the rewards of the company's success
 - **Hands-on, value driven** - insisting that executive keep in touch with the firm's essential business
 - **Stick to the knitting** - remaining with the business the company knows best
 - **Simple form, lean staff** - few administrative layers, few people at the upper levels
 - **Simultaneous loose-tight properties** - fostering a climate where there is dedication to the central values of the company combined with tolerance for all employees who accept those values.

***Thriving on Chaos: Handbook for a Management Revolution, 1987 - organizations must be designed to be* dynamic, to be adaptive, to operate under constant change - Example: Bees, flies & a glass jar; the 'fly' system handles change**

- *Liberation Management: Necessary Disorganization for the Nanosecond Nineties*, 1992.
- Control via hierarchical organization is no longer effective
- Organizations should and will be run using small entrepreneurial teams
- Markets are becoming fickle, ephemeral, impermanent, fleeting

William Ouchi -

Theory Z: How American Business

Can Meet the Japanese Challenge, 1982

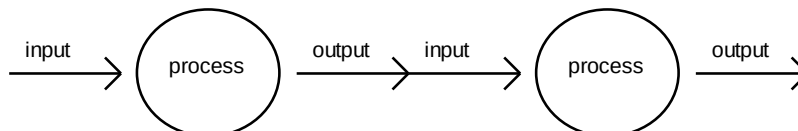
Japanese workers are viewed as neither "good" (Theory Y) nor "bad," (Theory X) but *are* the organization, involved in all aspects of the decision making process

- **Worker empowerment**, structures for increasing the ability and authority of workers to make corporate decisions typically reserved for management.
- **Management concern for quality of work life** (qwl) through lifetime employment, trust and intimacy in professional relationships, slow and equitable promotion and advancement
- **A culture of "win/win" cooperation** (versus "win/lose" competition).example: win/win and win/lose sales forces

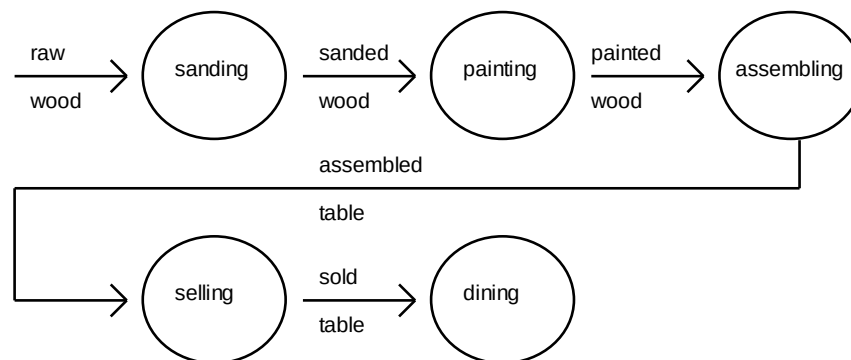
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The Systematic School of Management Thought

Views organizations as made up of 'input-process-output' building blocks



Here's a simple example from elsewhere my notes...



Embraces techniques that integrate both scientific management and sociological/psychological techniques.

('Human nature' must be included.)

- Chester Barnard - According to your book, Barnard is also a "systems thinker." Ok?

The Functions of the Executive, 1938

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- Organizations must adjust to a constantly changing external environment.
- Individuals join organizations to cooperatively reach goals unattainable individually
- Getting people to believe in organizational goals is a major function of managers

Acceptance Theory of Authority
flows upwards or "bottom-up"

- Authority in organizations really

- Example: Getting a PC one part at a time
- Example: Work to Rule; "I'm smokin! Somebody stop me!"

W. Edwards Deming - *Out of the Crisis*, 1986

The New Economics for Industry, Government, Education, 1991

- The perspective of quality as a profit driver, rather than as a cost driver.
- The integration of quantitative methods and efficiency concepts with psychological and social factors into a single system.
- The organizational goal of continuous improvement

Peter Senge - *The Fifth Discipline*, 1990 - Professor at MIT's Sloan School of Management

Five disciplines organizations must master to succeed

- Systems thinking
- Personal mastery of learning
- Mental modeling
- Shared vision building
- Team learning (the 'fifth' discipline)

Authors and their books

- 
- Functions of the Executive, Chester I. Barnard, 1938.
 - General and Industrial Management, Henri Fayol, 1916.
 - In Search of Excellence: Lessons from America's Best-Run Companies, Tom Peters & Robert H. Waterman, Jr., 1982.
 - Motivation and Personality, Abraham H. Maslow, 1954.
 - Quality or Else: The Revolution in World Business, Lloyd Dobyns and Clare Crawford-Mason, 1990
 - The Human Problems of an Industrial Civilization, Elton Mayo, 1933
 - The Human Side of Enterprise, Douglas McGregor, 1960
 - The New Science of Management Decision, Herbert A. Simon, 1960.
 - The Principles of Scientific Management, Fredrick W. Taylor, 1911
 - The Protestant Ethic and the Spirit of Capitalism, Max Weber, 1930
 - The Third Wave, Alvin Toffler, 1980.

- Theory Z: How American Business Can Meet the Japanese Challenge, William Ouchi, 1982
- Wealth of Nations, Adam Smith, 1776

Some Definitions

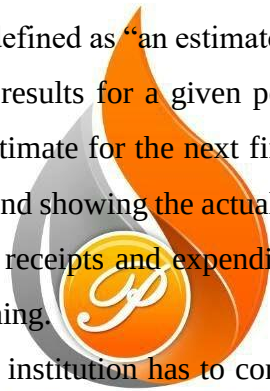
- "Management is an art of knowing what is to be done and seeing that it is done in the best possible manner." (planning and controlling) - F.W. Taylor (father of scientific management)
- "Management is to forecast, to plan, to organize, to command, to coordinate and control activities of others." - Henri Fayol (father of modern management)
- "Management is the process by which co-operative group directs actions towards common goals." - Joseph Massie
- "Management is that process by which managers create, direct, maintain and operate purposive organisation through systematic, coordinated and cooperative human efforts." - McFarland
- "Management is the coordination of all resources through the process of planning, organising, directing and controlling in order to attain stated goals." - Henry Sisk
- "Management is a social and technical process that utilises resources, influences human action and facilitates changes in order to accomplish an organization's goals." - Tho Harmann, William Scott
- "Management is a process of working with and through others to achieve organizational objectives in a changing environment, central to this purpose is the effective and efficient use of limited resources." - Rovert Kreitner
- "Management is a responsible person's or group's thinking processes and administrative processes directed at achieving the purpose, needs, aspirations and objectives of an organization, project or task through people." - Universal Management System Standard MSS 1000 - CQI Integrated Management Special Interest Group

Functions of Management

In 1937, L. Gulic and L. Urwick in “papers on the Science of administration” listed seven functions of management. They coined the acronym POSDCORB for the same. This stands for Planning, Organizing, Staffing, Directing, Coordinating, Reporting and Budgeting.

- ✓ **Planning:** Plan is regarded as a “projected course of action”. According to Koontz and O’Donnell, planning is deciding in advance what to do and how to do it, when to do it and who is to do it. It involves developing objectives, strategies, policies, procedures, programmes, etc.
- ✓ **Organizing:** Organizing means establishing of a formal structure of authority, which is well defined and co-ordinated towards the attainment of specific objectives. At this stage the objectives are set, methods are formulated, process of implementation are fixed, papers are ready, decision for doing the job is taken and all necessary steps are taken to perform the job.
- ✓ **Staffing:** Staffing refers to the human resources already existing in the organization and the new recruitment. The manager should assess the existing man-hour and capabilities of the existing persons employed.
- ✓ **Directing:** Directing is defined as the continuous task of taking decisions and incorporating them in specific and general order and serving these orders. That’s why directing involves overall administrative control. It is the administrative command over the affairs. In this sense directing is taking the leadership over all the matters as a whole for the present as well as for the future. Directing not only means just to issue the order but also to motivate the staff to get the best result.
- ✓ **Coordinating:** Coordinating in an organization is balancing and interrelating of the various parts of organization and keeping together all the staff for getting the best result with the minimum resources at hand. In any organization the division of work is distributed and at every stage a person is responsible to somebody for his performance and jobs to be done by him. The staffs are generally responsible to their immediate superior. There are various work units, sections and divisions for respective responsibilities but for proper coordination all these individual units must be interrelated and works should be done in a chain system, one after another

- ✓ **Reporting:** Reporting is the way to keep the authorities and the concerned public informed about the performance, achievements and shortfall of the organizations. It is a means of keeping informed to whom executive is responsible as to what is going on, which thus include keeping himself and his subordinates informed through records, research and inspection. Reporting is the preparation of factual data of the work done in a unit or section. These unit or section reports are amalgamated to prepare the full report of the working of the institution for a given period. The report is then transmitted to the top administrative body. The report contains the work done in various units, any progress made, constraints felt and the suggestion to overcome these, any backlog in the work and the reasons thereof, actual work done with statistical figure and the like.
- ✓ **Budgeting:** Budgeting is defined as “an estimated often itemized or expected income and expense or operating results for a given period in the future. Budgeting is the preparation of financial estimate for the next financial year, anticipate allotment for the present financial year and showing the actual expenditure incurred in the previous financial year. It involves receipts and expenditure as well as accounting, financial control and financial planning.
- ✓ **Control:** The chief of any institution has to control effectively his subordinates. He has to inspect their work personally. He has to keep an eye upon the methods of performing specific jobs assigned to individual workers, the end products and overall cost of productions / services. He has to ensure best quality and maximum quantity of work from his worker.
- ✓ **Motivation:** The aim of an organization cannot be achieved unless its workers perform their jobs willingly and conscientiously. So to do the same the worker must be motivated by providing congenial service conditions and environments. An individual can be motivated by two kinds of needs – Basic needs and those that is socially determined and that both of these must be satisfied to allow emotional maturity. The motivation of personnel through promotion, recognition and incentives create proper environment for employees to put in their best effort.



Roles performed by managers

In his classic book, *The Nature of Managerial Work*, Henry Mintzberg describes a set of ten roles that a manager fills. These roles fall into three categories:

- **Interpersonal:** This role involves human interaction.
- **Informational:** This role involves the sharing and analyzing of information.
- **Decisional:** This role involves decision making.

TABLE 1 Mintzberg's Set of Ten Roles

Category	Role	Activity
Informational	Monitor	Seek and receive information; scan periodicals and reports; maintain personal contact with stakeholders.
	Disseminator	Forward information to organization members via memos, reports, and phone calls.
	Spokesperson	Transmit information to outsiders via reports, memos, and speeches.
Interpersonal	Figurehead	Perform ceremonial and symbolic duties, such as greeting visitors and signing legal documents.
	Leader	Direct and motivate subordinates; counsel and communicate with subordinates.
	Liaison	Maintain information links both inside and outside organization via mail, phone calls, and meetings.
Decisional	Entrepreneur	Initiate improvement projects; identify new ideas and delegate idea responsibility to others.
	Disturbance handler	Take corrective action during disputes or crises; resolve conflicts among subordinates; adapt to environments.
	Resource allocator	Decide who gets resources; prepare budgets; set schedules and determine priorities.
	Negotiator	Represent department during negotiations of union contracts, sales, purchases, and budgets.

- ✓ **Technical:** This skill requires the ability to use a special proficiency or expertise to perform particular tasks. Accountants, engineers, market researchers, and computer scientists, as examples, possess technical skills. Managers acquire these skills initially through formal education and then further develop them through training and job experience. Technical skills are most important at lower levels of management.
- ✓ **Human:** This skill demonstrates the ability to work well in cooperation with others. Human skills emerge in the workplace as a spirit of trust, enthusiasm, and genuine involvement in interpersonal relationships. A manager with good human skills has a high degree of self-awareness and a capacity to understand or empathize with the feelings of others. Some managers are naturally born with great human skills, while others improve their skills through classes or experience. No matter how human skills are acquired, they're critical for all managers because of the highly interpersonal nature of managerial work.
- ✓ **Conceptual:** This skill calls for the ability to think analytically. Analytical skills enable managers to break down problems into smaller parts, to see the relations among the parts, and to recognize the implications of any one problem for others. As managers assume ever-higher responsibilities in organizations, they must deal with more ambiguous problems that have long-term consequences. Again, managers may acquire these skills initially through formal education and then further develop them by training and job experience. The higher the management level, the more important conceptual skills become.

Following are some of the skills and personal characteristics that the American Assembly of Collegiate Schools of Business (AACSB) is urging business schools to help their students develop.

- **Leadership** — ability to influence others to perform tasks
- **Self-objectivity** — ability to evaluate yourself realistically
- **Analytic thinking** — ability to interpret and explain patterns in information
- **Behavioral flexibility** — ability to modify personal behavior to react objectively rather than subjectively to accomplish organizational goals
- **Oral communication** — ability to express ideas clearly in words

- **Written communication** — ability to express ideas clearly in writing
- **Personal impact** — ability to create a good impression and instill confidence
- **Resistance to stress** — ability to perform under stressful conditions
- **Tolerance for uncertainty** — ability to perform in ambiguous situations

Some Definition

- ✓ “According to koontz and O Donnell defines planning is deciding in advance what to do, how to do it, when to do it and who is to do it. Planning bridges the gap from where we are to where we want to go. It makes it possible for things to occur which would not otherwise happen”
- ✓ According to Henri Fayol “To organize a business means to provide it with everything useful to its functioning-raw materials, tools, capital and personnel”
- ✓ According to koontz and O Donnell “The managerial functions of staffing involves manning the organizational structure through proper and effective selection, appraisal and development of personnel to fill the roles designed in to the structure.
- ✓ “According to Harold koontz controlling is the measurement and correction of performance in order to make sure that enterprise objectives and the plans devised to attain them are accomplished”



Function of management discovered by different authors

❖ Henry Fayol

He discovered 5 functions of management

- ✓ Planning
- ✓ Organizing
- ✓ Commanding: supervising subordinates in day to day task and pushing them towards company goal
- ✓ Coordinating: balancing the procedures and activities performed by the company
- ✓ Controlling

❖ **Lyndall Urwick**

He identified 6 function of management

- ✓ Planning
- ✓ organizing
- ✓ Commanding
- ✓ co ordinating
- ✓ Controlling
- ✓ Forecasting :relying on data from the past and present, and analysis of trends

❖ **Luther Gullick**

1937 he created (POSDCORB), the 7 function of management

- ✓ Planning
- ✓ Organizing
- ✓ Staffing
- ✓ Directing
- ✓ Co ordinating
- ✓ Reporting : keeping him and his subordinates informed through records and research etc.
- ✓ Budgeting :fiscal planning, accounting and controlling



❖ **Koontz & O' Donnel**

- ✓ They discovered 5 function of management
- ✓ Planning
- ✓ Organizing
- ✓ Staffing
- ✓ Leading :is the same meaning as directing
- ✓ Controlling

❖ **Earnest dale**

According to him functions of managements are:

- ✓ Planning
- ✓ Organizing
- ✓ Staffing
- ✓ Directing
- ✓ Controlling
- ✓ Innovation: making or introducing, such as new methods and new procedures etc.
- ✓ Representation: representing his organization in front of stake holders

ORGANISATIONAL BEHAVIOUR

Definitions

Robbins - O.B. is a field of study that investigate the impact that individuals, groups and structure have, on behavior within organization for the purpose of applying such knowledge towards improving organization's effectiveness.

Aldag and Brief - O.B. is a branch of the social sciences that seeks to build theories that can be applied to predicting, understanding and controlling behavior in work organizations.

Callahan - Organization behavior is subset of management activities concerned with understanding, predicting and influencing individual behavior in organizational settings.

Joe Kelly - O.B. is concerned with the study of the behavior and attitudes of man in an organizational setting, the organization's effects on his perception, feelings and actions and particularly on his behavior for the achievement of the organization's purposes.

Newstrom - O.B. is systematic and careful application of knowledge about how people, as individuals and as groups, act within organizations.

Fred Luthans - Organizational behavior is the understanding, prediction and management of human behavior in organizations.

Ivancevich, Knonopaske and Matteson - Organizational Behaviour is the study of human behavior, attitudes and performance within an organizational setting.

Moorhead and Griffin - Organizational Behavior is the study of human behavior in organizational settings, the interface between human behavior and the organization, and between the organizations itself.

Key elements of O.B.

- People
- Structure
- Technology
- Environment in which the organisation operates

Nature of Organizational Behavior

- **Field of study and not a discipline**

Organisational behavior can be treated as a distinct field of study and not a discipline or even emerging discipline. A discipline is an accepted science with a theoretical foundation that serves as the basis for research and analysis. O.B because of its broad base, recent emergence, and interdisciplinary orientation, is not accepted as science.

- **Predicts human behavior**

It is not a study of emotional feelings of employee. It is to explain and predict human behavior of people in organisations.

- **Interdisciplinary approach**

O.B is basically an interdisciplinary approach i.e. it draws the knowledge from different disciplines like psychology, sociology and anthropology, economics, political science, law and history.

- **Multiplicity**

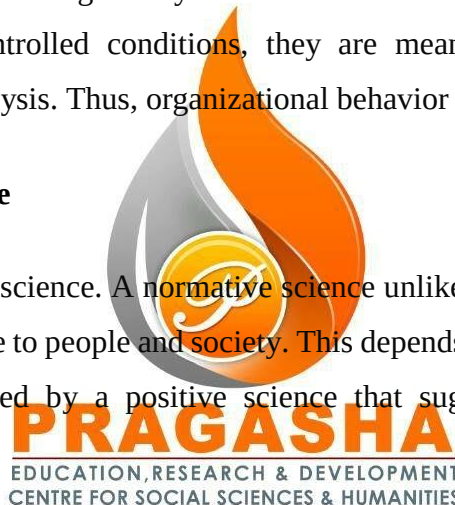
Organizational behavior deals with the behavior of people at different levels i.e. individuals, groups and organizations. Behavior attributable at each of these levels can be both identified and isolated.

- **Science and art**

The basic objective of OB is to make application of various researches to solve the organizational problems particularly related to human behavior aspect. Unlike the pure science which concentrated on fundamental researches. OB concentrates on applied researches. Though many of the researches may be carried on in laboratory situations and controlled conditions, they are meant for general application in organizational analysis. Thus, organizational behavior is both science as well as art.

- **Normative Science**

OB is a normative science. A normative science unlike the positive science suggests what are acceptable to people and society. This depends upon values of society which cannot be explained by a positive science that suggests only cause and effect relationships.



- **Humanistic and Optimistic**

OB focuses the attention on people from humanistic point in view. It is based on the belief that needs and motivation of people are of high concern.

- **Orientation towards Organizational Objective**

Behavior is rational and oriented to organizational objectives. Different objectives exist in organizations but OB tries to integrate them. Once the organizational objectives are achieved other objectives such as individual and group objectives are also achieved simultaneously.

- **Total system approach**

Organization is a system where different variables are linked to one another. The systems approach is an integrative approach which takes into account all the variables affecting organizational functioning. OB does not take man in isolation but as the product of socio-psychological factors. Behavior goes by psychological framework, interpersonal orientation group influence, social and cultural factors. Thus man's nature is quite complex and OB by applying systems approach tries to find solution of this complexity.

- **Pervasive**

OB is all pervasive in nature since organizations do not exist without people. Wherever people exist there changes occur hence managers have to ensure continuity in organizations by influencing their behavior for successful accomplishment of objectives set for organisations.

- **Perpetual**

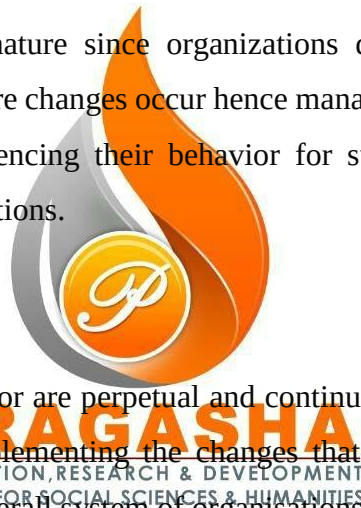
Changes of human behavior are perpetual and continuous. Managers have to ensure welfare to people by implementing the changes that occur from time to time by moulding people to the overall system of organisations.

- **Adaptability**

Individuals or groups adapt themselves to the changes occur in organizational environment. Their behavior change with changes occurring in environment. OB considers this factor and develops suitable techniques that managers have to observe while supervising the human factor.

Evolution of OB

- ✓ The writings of 16th century Italian philosopher Niccolo Machiavelli laid the foundation for contemporary work on organizational power and politics.



- ✓ In 1776, Adam Smith advocated a new form of organizational structure based on the division of labour. One hundred years later, German sociologist Max Weber wrote about rational organizations and initiated discussion of charismatic leadership. Soon after, Frederick Winslow Taylor introduced the systematic use of goal setting and rewards to motivate employees.
- ✓ In the 1920s, Australian-born Harvard professor Elton Mayo and his colleagues conducted productivity studies at Western Electric's Hawthorne plant in the United States. This shift of focus in the study of organisations was called the Hawthorne Effect. The Human Relations Movement focused on teams, motivation, and the actualization of goals of individuals within organisations. The Human Relations Movement focused on teams, motivation, and the actualization of goals of individuals within organisations.
- ✓ Studies conducted by prominent scholars like Chester Barnard, Henri Fayol, Mary Parker Follett, Frederick Herzberg, Abraham Maslow, David McClelland and Victor Vroom contributed to the growth of Organisational Behavior as a discipline.

Importance of Organisational Behavior

- ✓ It helps an individual to understand himself and his associates so that interpersonal relations get improved.
- ✓ The areas of improvement are attitude, perception, leadership, communication, conflict etc. which change largely in their functioning
- ✓ It helps the manager to induce motivation in his subordinates for doing better work.
- ✓ It helps in creating cordial relationship between manager and his subordinates as often the indifferent attitude of the manager makes his subordinate lazy and irritating.
- ✓ Sometimes the relation between management and workers become strained due to some personal ego which should be tackled humanly.
- ✓ It helps to understand the cause, provide course of action and then control its result.
- ✓ It also helps in the area of marketing as it provide awareness to the individual and amend social processes for the success of the organization.
- ✓ Marketing process also depends upon the learning of responses of individual and groups.

- ✓ It also provides manager how to predict behavior and apply in the organization to make it more effective.
- ✓ It is a discipline which makes management effective to deal with human resource to get higher productivity and better results.

Limitations of O.B.

- ✓ People who lack understanding of the system may develop a behavioral bias. Behavioural bias refers to fact that sometimes concern for employees may overshadow the needs of the organisation.
- ✓ Organisational behavior cannot abolish conflict and frustration but can only reduce them. It is a way to improve but not an absolute answer to problems.
- ✓ It has not contributed much regarding improving industrial relations as workers has not stopped strikes or layout even after many orientation programmes.
- ✓ It is said organizational behavior is descriptive about behavior already taken but it is not able to prevent it recurrence.
- ✓ It simply serves the interest of the management by putting emphasis on motivation, efficiency and productivity only.
- ✓ People can misuse the knowledge of communication or motivation and unethically manipulate people.



Role of organizational Behavior

- ✓ Understanding human behavior
- ✓ Controlling and directing human behavior
- ✓ Organisational adaptation

Understanding human behavior

Individual level

- ✓ Human resource - backbone of every organization. Organisation behavior provides an understanding of why people behave as they do in the organization. The behavior of

individuals is affected by a number of psychological, social and cultural factors. Factors such as attitudes, beliefs, perception and personalities have a deep impact on the behavior of individuals.

Interpersonal level

- ✓ People in organization have to necessarily work in coordination with others to meet organizational goals. This is achieved by creating teams, committees and work groups.
- How do people work together in groups?
- What factors determine whether the group will be cohesive and productive?
- What type of tasks could be assigned to the groups?
- The Hawthorne experiments have shown that an individual behaves differently when he works alone and when he works in a group.

Group level

- ✓ Though people interpret anything at their individual level, they are often modified by group pressure which thus becomes a force in shaping human behavior

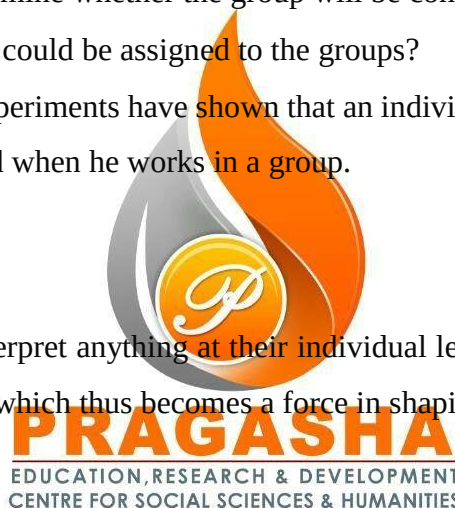
Intergroup Level

- ✓ The organization is made up of many groups that develop a complex of relationships to build its process and substance. Understanding of the effect of group relationships is important for managers in today's organization. Intergroup relationships may be in the form of cooperation or competition.

Controlling and Directing Behavior

Use of Power and Sanction

- ✓ O.B. can be controlled and directed by the use of power and sanction which are formally prescribed by the organization. Power is referred to as capacity of an



individual to take certain action and may be utilized in many ways. The use of power is related with sanction in the organization.

Leadership

- ✓ Another method of bringing human behavior in tune with organizational requirement is leadership

Communication

- ✓ Communication is the building block of an organization. It is communication through which people come in contact with others.

Organisational Climate

- ✓ Organisational climate refers to the total organizational situations affecting human behavior. Organisational climate takes a systems perspective and affects human behavior. Organisational behavior suggests the approach to create organizational climate in totality rather than merely improving the physiological conditions or increasing employee satisfaction by changing isolated work process.

Different Approaches for studying Organisational Behavior



Human Resource approach

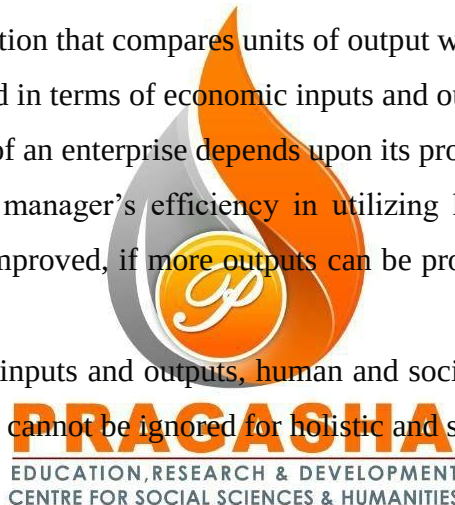
- ✓ The people are most important resource in an enterprise.
- ✓ They should be developed to reach higher levels of creating and competency for the success of the enterprise.
- ✓ The approach helps employees become better in terms of work and responsibility and then it tries to create a climate in which they can contribute to the best of their improved abilities.
- ✓ It is also called the supportive approach as the managerial role is changed from control of employees to support of employees in their performance.

Contingency Approach

- ✓ It is called situational approach which predicts that the method which works well in the one situation will fail in another.
- ✓ Manager has to use his skill to find out which method is most suited for a particular situation at that time.
- ✓ Thus, it gives more importance to the analysis of each situation before taking any action on it.
- ✓ This is the most disciplined, systematic and research oriented approach.

Productivity approach

- ✓ Productivity is a ration that compares units of output with units of input.
- ✓ It is often measured in terms of economic inputs and outputs.
- ✓ The effectiveness of an enterprise depends upon its productivity.
- ✓ It also shows the manager's efficiency in utilizing his resources. Productivity is considered to be improved, if more outputs can be produced form the same amount of inputs.
- ✓ Besides economic inputs and outputs, human and social inputs and outputs are also very important and cannot be ignored for holistic and sustainable development.



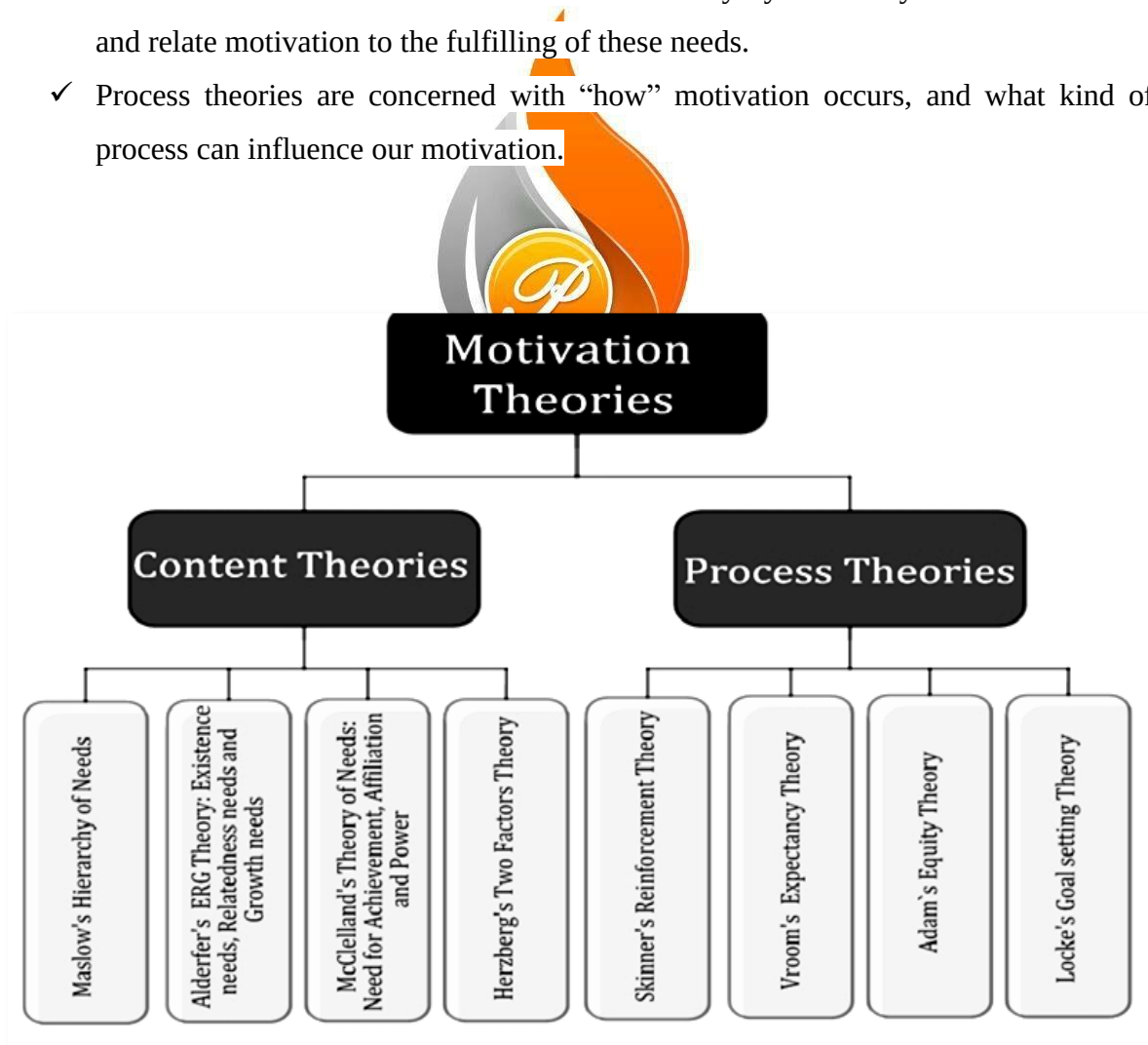
Systems approach

- ✓ A system is an interrelated part of an organization or a society that interacts with everyone related to that organization or society and functions as a whole.
- ✓ System approach vies the organization as a united and inter related system.
- ✓ Thus, managers treat the organization as a whole group.
- ✓ It emphasize that the activity of any department of the organization affect the other departments.
- ✓ Thus, everybody is concerned and responsible in the system the managers who make decision for everyday activities.

- ✓ Managers use organizational behavior to accomplish individual, social and organizational goals for which they build an organizational culture to motivate and use talents of the people.

Motivation theories

- ✓ **Content theories focus on WHAT**, while **process theories focus on HOW human behavior is motivated.**
- ✓ Content theories are the earliest theories of motivation.
- ✓ Content theories are also called needs theories: they try to identify what our needs are and relate motivation to the fulfilling of these needs.
- ✓ Process theories are concerned with “how” motivation occurs, and what kind of process can influence our motivation.



The **main content theories**

- ✓ Maslow's needs hierarchy,
- ✓ Alderfer's ERG theory,
- ✓ McClelland's achievement motivation and
- ✓ Herzberg's two-factor theory

The **main process theories**

- ✓ Skinner's reinforcement theory,
- ✓ Victor Vroom's expectancy theory,
- ✓ Adam's equity theory and
- ✓ Locke's goal setting theory

Contents Theories

Maslow – hierarchy of needs

- 
- ✓ This is the earliest and most widely known theory of motivation, developed by Abraham Maslow (1943) in the 1940s and 1950s.
 - ✓ **Physiological needs** (e.g. food, water, shelter, sleep)
 - ✓ **Safety and security** (secure source of income, a place to live, health and well-being)
 - ✓ **Belongingness and love** (integration into social groups, feel part of a community or a group; affectionate relationships)
 - ✓ **Esteem** (respect for a person as a useful, honourable human being)
 - ✓ **Self-actualization** (individual's desire to grow and develop to his or her fullest potential)

Alderfer – ERG theory: Existence needs, relatedness needs and growth needs

- ✓ **Existence needs:** These include needs for basic material necessities. In short, it includes an individual's physiological and physical safety needs.

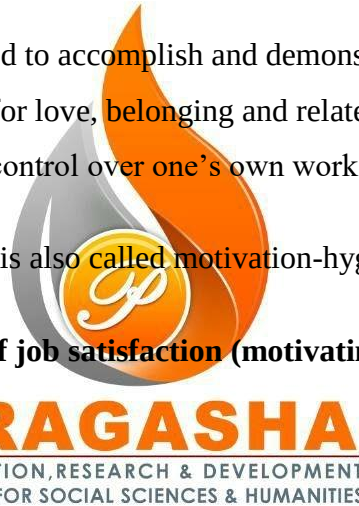
- ✓ **Relatedness needs:** Individuals need significant relationships (be with family, peers or superiors), love and belongingness, they strive toward reaching public fame and recognition. This class of needs contain Maslow's social needs and external component of esteem needs.
- ✓ **Growth needs:** Need for self-development, personal growth and advancement form together this class of need. This class of needs contain Maslow's self-actualization needs and intrinsic component of esteem needs.

McClelland – Need for achievement, affiliation and power

- ✓ In the early 1960s McClelland – built on Maslow's work – described three human motivators
 - achievement: a need to accomplish and demonstrate competence or mastery
 - affiliation: a need for love, belonging and relatedness
 - power: a need for control over one's own work or the work of others

Herzberg – Two factor theory - It is also called motivation-hygiene theory.

- ✓ **Herzberg's five factors of job satisfaction (motivating factors):**
 - achievement
 - recognition
 - work itself
 - responsibility
 - advancement
- ✓ **Herzberg's five factors of job dissatisfaction (hygiene factors – deficiency needs):**
 - company policy and administration
 - supervision
 - salary
 - interpersonal relationships
 - working conditions



Summary of Content Theories of Motivation (Source: Author's own table)

Maslow	Alderfer	McClelland	Herzberg
Physiological	Existence		
Safety and security			
Belongingness and love	Relatedness	Need for Affiliation	Hygiene
Self-esteem	Growth	Need for power	Motivators
Self-actualization		Need for achievement	

Process theories

Skinner's reinforcement theory

- ✓ The Reinforcement theory, based on Skinner's operant conditioning theory, says that behavior can be formed by its consequences (Gordon, 1987).
- ✓ **Positive reinforcements** - for example praise, appreciation, a good mark/grade, trophy, money, promotion or any other reward can increase the possibility of the rewarded behaviors' repetition.
- ✓ **Negative reinforcement - punishment** can be undesired reinforcement, or reinforce undesired behavior



Vroom's expectancy theory

- ✓ Victor Vroom's (1964) expectancy theory aims to explain how people choose from the available actions. Vroom defines motivation as a process that governs our choices among alternative forms of voluntary behavior. The basic rationale of this theory is that motivation stems from the belief that decisions will have their desired outcomes
 - **Expectancy** – a person's belief that more effort will result in success. If you work harder, it will result in better performance.
 - **Instrumentality** – the person's belief that there is a connection between activity and goal. If you perform well, you will get reward.

- **Valence** – the degree to which a person values the reward, the results of success.

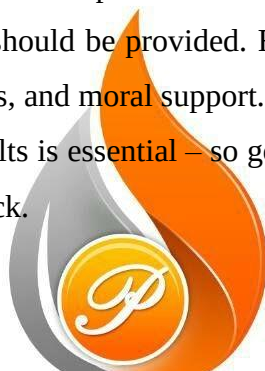
Adams' equity theory

- ✓ The equity theory states that people are motivated if they are treated equitably, and receive what they consider fair for their effort and costs.
- ✓ The theory was suggested by Adams (1965) and is based on Social Exchange theory.
- ✓ According to this theory, people compare their contribution to work, costs of their actions and the benefits that will result to the contribution and benefits of the reference person.
- ✓ If people perceive that the ratio of their inputs-outputs to the ratio of referent other's input-output is inequitable, then they will be motivated to reduce the inequity
- ✓ **When inequity exists, a person might...**
 - reduce his/her inputs, efforts, quantity or quality of his/her work
 - try to increase his/her outputs (ask for better mark, or pay raising)
 - adjust his/her perception of reference person or his/her outcomes or inputs (re-evaluate his/her or the reference person's effort or outcome)
 - change the reference person
 - quit the situation.

Locke's goal-setting theory

- ✓ Locke's (1990) goal setting theory is an integrative model of motivation just like the expectancy theory.
- ✓ It emphasizes that setting specific, challenging performance goals and the commitment to these goals are key determinants of motivation. Goals describe a desired future, and these established goals can drive the behaviour. Achieving the goals, the goal accomplishment further motivates individuals to perform.

- Set challenging but attainable goals. Too easy or too difficult/unrealistic goals don't motivate us.
- Set specific and measurable goals. These can focus toward what you want, and can measure the progress toward the goal.
- Goal commitment should be obtained. If people don't commit to the goals, then they will not put effort toward reaching the goals, even specific, or challenging ones. Strategies to achieve this could include participation in the goal setting process, use of extrinsic rewards (bonuses), and encouraging intrinsic motivation through providing workers with feedback about goal attainment. Pressure to achieve goals is not useful because it can result in dishonesty and superficial performance.
- Support elements should be provided. For example, encouragement, needed materials, resources, and moral support.
- Knowledge of results is essential – so goals need to be quantifiable and there needs to be feedback.



Leadership Styles

In the book “Primal Leadership,” Daniel Goleman, who popularized the notion of “Emotional Intelligence,” describes six different styles of leadership.

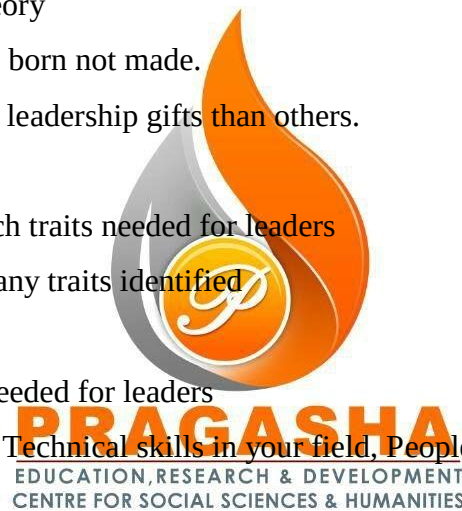
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- ✓ **Visionary.** This style is most appropriate when an organization needs a new direction. Its goal is to move people towards a new set of shared dreams. “Visionary leaders articulate where a group is going, but not how it will get there – setting people free to innovate, experiment, take calculated risks,”
- ✓ **Coaching.** This one-on-one style focuses on developing individuals, showing them how to improve their performance, and helping to connect their goals to the goals of the organization.
- ✓ **Affiliative.** This style emphasizes the importance of team work, and creates harmony in a group by connecting people to each other. Mr. Goleman argues this approach is particularly valuable “when trying to heighten team harmony, increase morale, improve communication or repair broken trust in an organization.”

- ✓ **Democratic.** This style draws on people's knowledge and skills, and creates a group commitment to the resulting goals. It works best when the direction the organization should take is unclear, and the leader needs to tap the collective wisdom of the group.
- ✓ **Pacesetting.** In this style, the leader sets high standards for performance. He or she is "obsessive about doing things better and faster, and asks the same of everyone.
- ✓ **Commanding.** This is classic model of "military" style leadership – probably the most often used, but the least often effective. Because it rarely involves praise and frequently employs criticism, it undercuts morale and job satisfaction.

Ten Leadership theories

- ✓ The Great Man theory
 - Good leaders are born not made.
 - Some have more leadership gifts than others.
- ✓ The Trait Theory
 - Determined which traits needed for leaders
 - Problem: Too many traits identified
- ✓ The Skills theory
 - Practical skills needed for leaders
 - 3 types of skills: Technical skills in your field, People skills, Conceptual skills
- ✓ The Style theory
 - Managerial grid: Concern for people vs concern for performance
 - Goal: Be people-friendly but insist on performance
- ✓ Situational leadership
 - No one-size-fits-all leadership
 - Must adapt to situation, assume static
 - e.g. Coaching boys vs girls
- ✓ Contingency theory
 - Change the leader based on situation
 - Effective leadership is "contingent" on matching the leader's style to the setting



- ✓ Transactional leadership
 - There's a reciprocal between leader and follower
 - Leader finds right mix of reward and punishment
- ✓ Transformational leadership
 - Leaders inspire them to a vision
 - Cultivate followership rather than paying for it or punishing non-compliance
- ✓ Leader-member exchange theory
 - Leadership is fair exchange between leader and member.
 - However exchange creates an in and out group that lowers performance and retention.
 - Leaders mustn't alienate people.
- ✓ Servant leadership theory
 - Leader asks “How may I help you?”
 - Creates trust, cooperation, reciprocal service and higher performance.
 - Started from Jesus. People follow out of love and gratitude rather than out of compulsion or fear.



Types of Leadership Styles (Traditional Classification)

✓ **The Laissez-Faire Leader**



A laissez-faire leader lacks direct supervision of employees and fails to provide regular feedback to those under his supervision. Highly experienced and trained employees requiring little supervision fall under the laissez-faire leadership style. However, not all employees possess those characteristics. This leadership style hinders the production of employees needing supervision. The laissez-faire style produces no leadership or supervision efforts from managers, which can lead to poor production, lack of control and increasing costs.

✓ **The Autocrat**

The autocratic leadership style allows managers to make decisions alone without the input of others. Managers possess total authority and impose their will on employees.

No one challenges the decisions of autocratic leaders. Countries such as Cuba and North Korea operate under the autocratic leadership style. This leadership style benefits employees who require close supervision. Creative employees who thrive in group functions detest this leadership style.

✓ **The Participative Leader**

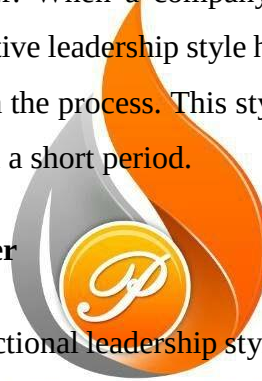
Often called the democratic leadership style, participative leadership values the input of team members and peers, but the responsibility of making the final decision rests with the participative leader. Participative leadership boosts employee morale because employees make contributions to the decision-making process. It causes them to feel as if their opinions matter. When a company needs to make changes within the organization, the participative leadership style helps employees accept changes easily because they play a role in the process. This style meets challenges when companies need to make a decision in a short period.

✓ **The Transactional Leader**

Managers using the transactional leadership style receive certain tasks to perform and provide rewards or punishments to team members based on performance results. Managers and team members set predetermined goals together, and employees agree to follow the direction and leadership of the manager to accomplish those goals. The manager possesses power to review results and train or correct employees when team members fail to meet goals. Employees receive rewards, such as bonuses, when they accomplish goals.

✓ **The Transformational Leader**

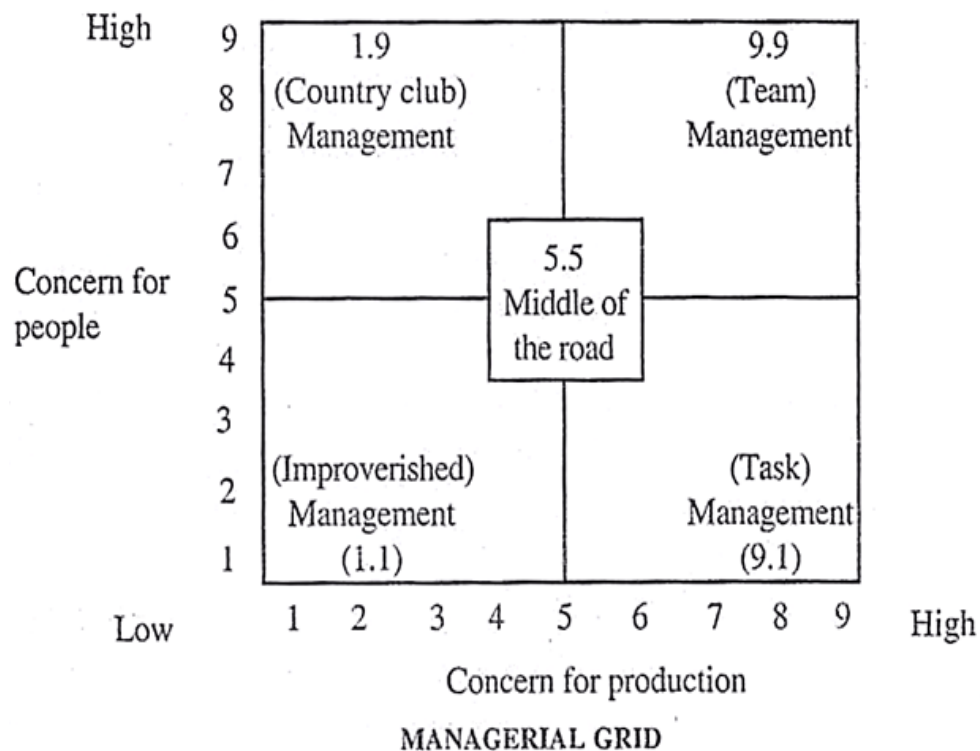
The transformational leadership style depends on high levels of communication from management to meet goals. Leaders motivate employees and enhance productivity and efficiency through communication and high visibility. This style of leadership requires the involvement of management to meet goals. Leaders focus on the big



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picture within an organization and delegate smaller tasks to the team to accomplish goals.

Managerial Grid Model of Leadership



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(1,9) Country Club Style Leadership High People and Low Production

- ✓ **(1,9) Country Club Style Leadership** style of leader is most concerned about the needs and the feelings of members of his or her team. In this environment, the relationship-oriented manager has a high concern for people but a low concern for production.
- ✓ He pays much attention to the security and comfort of the employees. He hopes that this will increase performance.

- ✓ He is almost incapable of employing the more punitive, coercive and legitimate powers. The organization will end up to be a friendly atmosphere but not necessarily very productive.
- ✓ The (1,9) boss mainly uses reward power to preserve discipline and to support his subordinates in accomplishing their goals.

(9,1) Produce or Perish Leadership- High Production and Low People

- ✓ **(9,1) Produce or Perish Leadership** management style is characterized by a concern for production as the only goal. Employees are viewed as obstacles to performance results unless obedience to the manager's wishes is explicitly granted.
- ✓ In this style, manager is authoritarian or compliance. A task-oriented manager, he has a high concern for production and a low concern for people.
- ✓ He finds employee needs unimportant and simply a means to an end. He provides his employees with money and expects performance back.

(1,1) Impoverished Leadership-Low Production and Low People:

- ✓ **(1,1) Impoverished Leadership** is a delegate-and-disappear management style and basically a lazy approach. The manager shows a low concern for both people and production.
- ✓ He or she avoids getting into trouble. His main concern is not to be held responsible for any mistakes. Managers use this style to preserve job and job seniority, protecting themselves by avoiding getting into trouble.

(5,5) Middle-Of-The-Road Leadership-Medium Production and Medium People

- ✓ **(5,5) Middle-Of-The-Road Leadership** is a kind of realistic medium without ambition. It is a balanced and compromised style. The manager tries to balance between the competing goals of the company and the needs of the workers.
- ✓ The manager gives some concern to both people and production, hoping to achieve acceptable performance. He believes this is the most anyone can do. Consequently, compromises occur where neither the production nor the people needs are fully met.

- ✓ The supervisor views it as the most practical management technique. It is also an outcome when production and people issues are seen as in conflict.

(9,9) Team Leadership-High Production and High People

- ✓ At (9,9) Team Leadership, the manager pays high concern to both people and production. Motivation is high. This soft style is based on the propositions of Theory Y of Douglas McGregor. The manager encourages teamwork and commitment among employees.
- ✓ This style emphasizes making employees feel part of the company-family and involving them in understanding the organizational purpose and determining production needs. This method relies heavily on making employees feel they are constructive parts of the company.
- ✓ And this will result in a team environment organization based on trust and respect, which leads to high satisfaction and motivation and, as a result, high production.

Advantages of Managerial Grid Model

- ✓ Managers help to analyze their own leadership styles through a technique known as grid training.
- ✓ Managers identify how they with respect to their concern for production and people.



Limitations of Managerial Grid Model

- ✓ The model ignores the importance of internal and external limits, matter and scenario.
- ✓ There is some more aspect of leadership that can be covered but are not.

Organization Change and Development

Nature of Organizational Change

- ✓ The term change refers to an alteration in a system whether physical, biological, or social thus **organizational change** is the alteration of work environment in the organization. **Organizational change** may have following features :
- ✓ When change occurs in any part of organization it disturb the old equilibrium of organization.
- ✓ Any change in organization can effect either whole organization or some part of organization directly or indirectly.
- ✓ **Organizational change** is a continuous process.

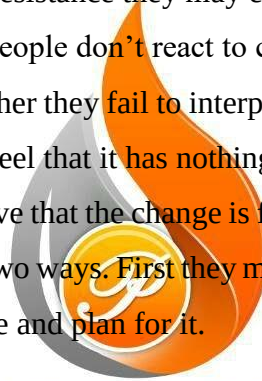
Causes of Organization Change

- ✓ **Government policies** - sometimes the government policies change due to which an organization has to bring change. For e.g. when computerization came into existence government banks make their employee change from manual process to computerized so organization has to go for a change.
- ✓ **Competition** - in order to sustain in a market any organization has to be competitive in nature as there is cut throat competition if one company is going for innovation other has to also go for it. For example in case of Coke and Pepsi if one goes for new advertisement another will also go for same and bring change in their advertisement policies.
- ✓ **Technology** - today is the world of new innovation day by day new technologies are emerging for example now a days computers have become obsolete and laptops and LCD's have emerged. So change is must.
- ✓ **Change in customer requirement** - customer is a king. So these days companies produce product as per customer demand. Accordingly every time a company makes changes in the product so change is must.
- ✓ **Change in managerial personnel** - employees come and leave organization every time a new manager will bring his own new ideas and make employees according to that and this is how change occurs in organization.
- ✓ **Deficiency in existing organization** - sometimes the managers in the organization think that there is deficiency in the existing organization system and in order to

compete and to survive there must be change in the organization. For example change in system from centralization to decentralization.

Human Reactions to Change

- ✓ When change is initiated both manager and employees react to it. Though human reaction to change depends on the outcomes of the change particularly its impact on their need satisfaction, often the attitudes of people play as a significant role in deciding human response to change.
- ✓ **Resistance**-people resist a change when they have a feeling that the change is unfavorable for them. Resistance to change becomes more forceful when the people have feeling that through resistance they may eliminate the change.
- ✓ **Indifference**-sometimes people don't react to change either positively or negatively. The reason may be that either they fail to interpret the outcome of the change on their need satisfaction, or they feel that it has nothing to do with them.
- ✓ **Acceptance**-if they perceive that the change is favorable for them they will accept the change. They can do it in two ways. First they may accept change and adopt it. Second they may anticipate change and plan for it.



Resistance to Change

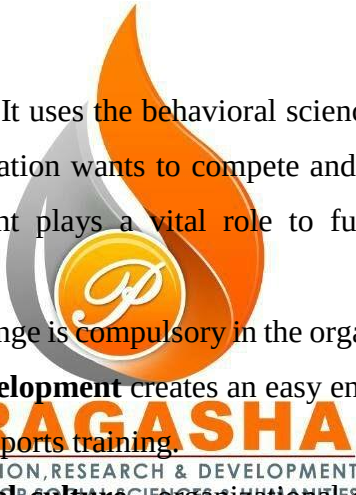
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- ✓ **Problem of adjustment** - perhaps most important factor for resistance to change is the problem of adjustment. Each individual tries to maintain a sort of equilibrium both at formal level as well as at informal level.
- ✓ **Economic reason** - people resist to change if they feel that it is likely to affect them unfavorably so far as their economic needs are concerned.
- ✓ **Emotional factor** - there are many emotional factors which resist change, especially if the past experience with the change level not been positive.
- ✓ **Fear of unknown** - change is future oriented. Therefore some amount of uncertainty is always there. People will not ready to accept change because of two reasons. First, people may derive benefits or otherwise in future while they have to pay the cost at

the present. Second, future is uncertain and the impact may be different from the expectations.

- ✓ **Ego defensiveness** - sometimes people resist change because it is ego deflating. Everyone has some ego it is the state of a person's way of behaving, thinking, and feeling any attack on ego will be resisted.
- ✓ **Social displacements** - whenever change takes place it often results in social displacement of people like breaking of informal groups and relationship. As a result there is a possibility for the employees to experience psychological let down therefore they dislike change.
- ✓ Need of Organizational Development

Organizational development

- 
- ✓ **It is a dynamic technique.** It uses the behavioral science knowledge to cope up with the change. Every organization wants to compete and to survive in the long run so organizational development plays a vital role to fulfill the need of survival of organization.
 - ✓ **Training for change** - change is compulsory in the organization to survive in the long run so **organizational development** creates an easy environment in the organization to bring changes that it supports training.
 - ✓ **Responsive organizational culture** - organizational development helps in making the organizational culture more responsive. It works in the all the direction of organization.

Benefits of organizational development

- ✓ It gives more emphasis on human resources rather than any other physical resources.
- ✓ It helps in development of human resources by initiating change.
- ✓ It provides opportunities and challenge for the human beings to use their abilities.
- ✓ It helps to achieve organizational effectiveness.

Limitation of Organizational Development

- ✓ **Organizational development** based on behavioral science approach which itself has to many limitations.
- ✓ **Organizational development** is applicable on the basis of circumstances available in organization. So if the circumstances are not proper, it can put limitation on effectiveness of **organizational development**.

Themes of Organizational Development

- ✓ **Planned change** - change means the new state of things and is different from old state of things. Change is everywhere due to internal as well as external factors. External factors may include competition; customer and technology internal factor may include new market opportunities, increasing diverse work force new direction etc.
- ✓ **Consultant's role/distinctive consulting method** - leader in organization hire an **organizational development** practitioner to solve the problem. The expert establishes relationship with the members of the organization. The practitioner does not provide any solution to the problem but he provides the learning to the members that how they should solve the problem by themselves.
- ✓ **Action research model** - it is described as a process that involves series of events and action.



LEARNING

Learning is relatively permanent change in behavior that occurs as a result of reinforced practice or prior experience. It is a process of having one's behavior modified, more or less permanently, by what one does and consequences of one's action, or what one observes.

THEORIES OF LEARNING

- Classical Conditioning Theory
- Operant Conditioning Theory
- Social Learning Theory
- Cognitive Learning Theory
- Situated Learning

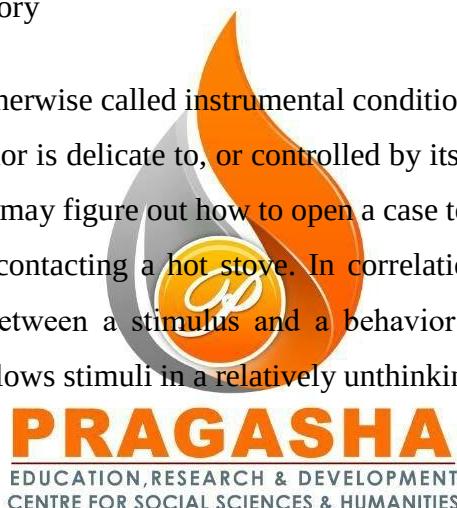
Classical Conditioning Theory

The classical conditioning happens when a conditioned stimulus is combined with an unconditioned stimulus. Pavlov's work with dogs is well-known. Dog owners are still trained today in the use of classical conditioning methods. If you show meat to a dog, it will produce saliva. The meat is the stimulus, the saliva is the response. The meat is an unconditioned stimulus (US), because the dog salivates naturally. Similarly, the saliva is an unconditioned response (UR). Unconditioned responses are also called reflexes. For the most part, the conditioned stimulus (CS) is an unbiased stimulus like the sound of a tuning fork, the unconditioned stimulus (US) is naturally viable.

Operant Conditioning Theory

Operant conditioning is otherwise called instrumental conditioning. This theory is a learning procedure in which behavior is delicate to, or controlled by its results. How about we take a case of a kid. A youngster may figure out how to open a case to get the treat inside, or figure out how to abstain from contacting a hot stove. In correlation, the classical conditioning builds up a connection between a stimulus and a behavior. B. F. Skinner's concept of Behaviorism: behavior follows stimuli in a relatively unthinking manner.

Key Concepts:



Conditioned behavior: voluntary behavior that is learned, not reflexive.

Reinforcement: the consequences of behavior which can increase or decrease the likelihood of behavior repetition.

Pleasing consequences increase likelihood of repetition.

Rewards are most effective immediately after performance.

Unrewarded/punished behavior is unlikely to be repeated.

SOCIAL LEARNING THEORY

According to this theory, Learning isn't precisely behavioral, rather it is a cognitive procedure that happens in a social setting. Learning can happen by watching a behavior and by watching the results of the behavior (known as vicarious reinforcement). Learning incorporates perception, extraction of data from those perceptions, and settling on choices with respect to the execution of the behavior (known as observational learning or displaying). In this manner, learning can happen past a noticeable change in behavior. Reinforcement assumes an imperative part in learning however isn't totally in charge of learning.

COGNITIVE LEARNING THEORY

Cognition characterizes a man's thoughts, contemplations, information, clarification, understanding about himself and condition. This theory considers learning as the result of deliberate thinking on an issue or circumstance in the light of well established actualities and reacting in a goal and more arranged way.

SITUATED LEARNING

Situated Learning Theory, created by Jean Lave and Etienne Wenger as a model of learning in a community of practice, advances that learning is involuntary and situated within authentic activity, context, and culture. Simply put, situated learning is learning that takes place in the same context in which it is applied. Situated learning is related to notion of learning through social development. Regular classroom learning activities involve abstract knowledge which is in and out of context.

Lave argues that learning is situated; that is,

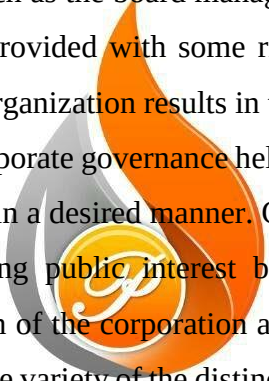
- It occurs normally (unintentional rather than deliberate)
- It is embedded within activity
- It is embedded within context and
- It is embedded within culture.

Lave and Wenger (1991) call this unintentional learning a process of “legitimate peripheral participation” or LPP. Implications of situated learning are : Knowledge needs to be presented

in authentic contexts — settings and situations that would normally involve that knowledge. Social interaction and collaboration are essential components of situated learning — learners become involved in a “community of practice” which embodies certain beliefs and behaviours to be acquired. As the beginner or novice moves from the periphery of a community to its centre, he or she becomes more active and engaged within the culture and eventually assumes the role of an expert.

Corporate governance and ethics

Corporate governance is defined as an act of controlling, directing and evaluating the activities of an organization. The structure of corporate governance specifies that the others taking part in the organization, such as the board managers, board of directors, shareholders and other stakeholders must be provided with some rights and responsibilities. Providing powers to the participants of the organization results in the monitoring of performance of the employees in an organization. Corporate governance helps the organization achieve the goals and objectives of an organization in a desired manner. Corporate governance has achieved a great deal of success in attracting public interest because corporate governance gives importance to the economic health of the corporation and the society as a whole. However, corporate governance covers a wide variety of the distinct economic phenomenon. Therefore, many people have given different definitions of corporate governance.


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A few definitions of corporate governance are as follows:

According to Shleifer and Vishny, ‘*Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.*’

An article from *Financial Times* has defined corporate governance as ‘*the relationship of a company to its shareholders or, more broadly, as its relationship to society*’.

According to the J. Wolfensohn, ‘*Corporate governance is about promoting corporate fairness, transparency and accountability.*’

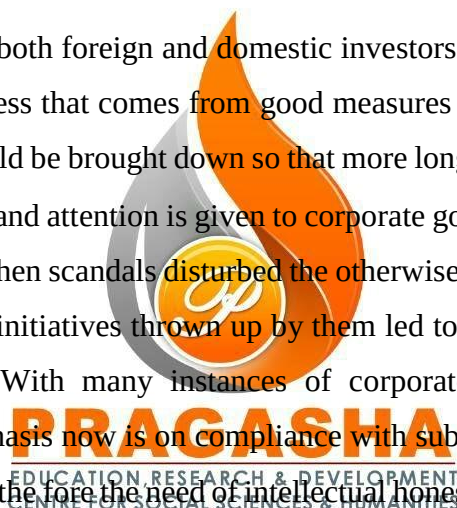
The Need for Corporate Governance

There are various reasons for the need for corporate governance in an organization. These are:

- A Corporation, which is a union of many stakeholders, such as employees, customers, investors, vendors, and so on, must be fair and transparent to its stakeholders in all its dealings. It is very important in today's globalized business world, where corporations require having access to global pools of capital attract and retain the best human resource from all parts of the globe. If a corporation does not take up and show ethical conduct, it is not considered to be successful.
- Corporate governance covers ethical conduct in business, the code of values and principles that helps an individual to choose between right and wrong or make the right selection from the options or alternatives provided. Managers decide on certain actions on the basis of an principles that are governed by the culture, context and values of an organization. An organization that follows ethical values feel that it is better for the business, as it helps in the long run and the stakeholders observe that the management is running the organization in the desired way.
- It is beyond the sphere of law, i.e., it stems from the background and outlook of the management and cannot be regulated by legislation alone. It deals with running the affairs of a company in such a way that it is fair to all the stakeholders and that its dealings benefit the greatest number of stakeholders. It is about honesty, integrity and responsibility. Laws should set up a common framework to maintain standards. Since substance is very much linked with the mindset and ethical standards of management, it shall in the end lay down the creditability and integrity of the process.
- Corporations should realize that it is necessary for all the stakeholders to cooperate in order to facilitate development. Such cooperation and support can only be possible by adhering to the best practices of corporate governance. In this context, management has to take the responsibility of the shareholders at large and stop any unbalanced benefits of the varied sections of the shareholders.
- The economic competence of a company can be improved through corporate governance. Corporate governance also ensures that corporations consider the

interests of a wide range of constituencies and also of the communities within which they function. Corporate governance also makes sure that the boards of directors are responsible to the shareholders. This even helps to ensure that corporations work for the benefit of the society at large, including the society's concerns about labour and environment.

- If the execution of good governance fails, heavy losses can result in terms of cost other than regulatory problems. Many organizations that do not give due importance to corporate governance end up paying a large risk premium while contending for scarce capital in the public markets. Of late, stock market analysts have started realizing, accepting and appreciating the relationship between returns and corporate governance.
- The confidence of both foreign and domestic investors is maintained and upheld due to the trustworthiness that comes from good measures of corporate governance. The cost of capital should be brought down so that more long-term investment is attracted.
- Often, importance and attention is given to corporate governance in times of financial crisis. In the US, when scandals disturbed the otherwise calm and contented corporate environment, new initiatives thrown up by them led to fresh debates in Asia and the European Union. With many instances of corporate misdemeanor coming into limelight, the emphasis now is on compliance with substance, rather than on form. It has also brought to the fore the need of intellectual honesty and integrity. The financial and other disclosures made by firms are only as good as the people who make it.
- In 1998, the Confederation of Indian Industry (CII) made public a desirable and voluntary code. This marked the beginning of corporate governance initiatives in India. Then, on the basis of the Kumarmangalam Birla Committee Report in February 2000, Securities and Exchange Board of India (SEBI) made the first formal regulatory framework for listed companies.
- Corporate governance has been defined in different ways. Many definitions do not give its scope and the motives of many of the definitions vary. However, the crux is that corporate governance is a concept and not an individual instrument. It encompasses necessary management and control structures of a company, the rules about the power relationship between owners, the board of directors, stakeholders and



others. The easiest definition of corporate governance has been given by the Cadbury Report. It has been paraphrased as, ‘the system by which business are directed and controlled’. The other all-inclusive definition has been given by the OECD (Organization for Economic Cooperation Code). According to it, corporate governance includes complex relationships among the management, its shareholders, board and others. It also establishes the framework through which the aims of the company are established and the methods of attaining those objectives and observing the working are decided.

- Corporate governance is aimed at increasing the long-term value of an organization for not only its shareholders, but also partners. It represents an amalgamation of all those involved in a process that is socioeconomic. It is imperative for all organizations to govern and manage. Corporate governance includes the entire stakeholder and at the same time the process is economic as well as social.
- Studies related to corporate governance practices conducted worldwide by various institutions clearly indicate that no single model is available for good corporate governance. The OECD also recognizes this. It also accepts the fact that a wide range of approaches to corporate governance have developed due to the differences that exist in institutional frameworks, legal systems as well as traditions in various countries. All good corporate governance regimes place high preference on the interests of shareholders, as the latter place their trusts on corporations to use their investment funds in an effective and wise manner.

Principles of Corporate Governance

Corporate governance includes principles such as honesty, trust, integrity, responsibility, accountability and commitment to the organization. Apart from these, the other principles of corporate governance are as follows:

- Rights and equitable treatment of shareholders: The organizations must acknowledge the rights of the shareholders and they must help the shareholders in exercising their rights effectively. Shareholders must also be encouraged to participate in the general meetings of an organization.

- Interests of other stakeholders: It is the duty of an organization to recognize the legal and other obligations of certain stakeholders.
- Role and responsibilities of the board: In order to deal with various issues of a business, an organization needs a wide range of skills among the members of the board. The members of the organization must work with great responsibility.
- Integrity and ethical behaviour: In order to promote ethical and responsible decision-making, organizations must develop a code of conduct for the directors of an organization.
- Disclosure and transparency: The roles and duties of directors must be clearly defined by an organization. Organizations must implement certain procedures in order to verify and safeguard the integrity of the organization. An organization must disclose the financial information to investors and shareholders.

Role of the Board of Directors in Corporate Governance

Board of directors is made up of individuals elected by a corporation's shareholders to oversee the management of the corporation. An organization allows different individuals or parties to add to the capital, expertise and their knowledge so that the organization can function efficiently without facing any difficulties. There are various participants in the organization such as investors and shareholders. They do not participate in the operations of the organization. Their main interest is to have a proportion of the share in the income of the organization. The shareholders and investors have the right to elect the board of directors of an organization in order to represent and protect their interests. The board of directors has the power and duty to form the corporate policies of an organization. Therefore, the board of directors has the powers to take certain decisions, which can in turn affect the long-run performance of the corporation. It means that the board of directors has a very significant function in the working of the business as it also oversees the top management of the organization.

The duties and rules that the board of directors has to follow are plainly laid down by the organization. It includes monitoring the performance of the company and its management and approving important business policies. The board of directors is fully briefed in advance

of board meetings and the matter that will be discussed in the meeting. The board of directors receives regular reports on the financial position of the organization, key areas of the organizations' operations and other issues.

The board of directors provides multi skills and knowledge to the organization and it also participates fully in making decisions on key issues that the organization faces. The organization follows its own performance review process to access how well the board and its committees are performing and how they might be further improved.

Responsibilities of the board of directors

The board of directors has to handle a wide variety of roles and responsibilities. There are certain laws and standards that define the responsibilities of the board of directors. These laws and standards differ from country to country. For example, the US does not have any laws and standards that the board of directors must comply with. The various responsibilities of the board of directors are as follows:

- 
- Providing continuity to the organization by setting up the organization as per the legal requirements and effectively advertising its products and services to the customers
 - Selecting and appointing a chief executive whose basic duty is to review and evaluate the performance of the organization and offering administrative guidance to the organization.
 - Governing the organization by setting up broad policies and objectives and monitoring whether the organization follows the policies
 - Acquiring the resources and finance for effectively running the day-to-day operations of the organization.
 - The board of directors must be accountable to the public for the products and services of the organization, which include approving the budget and formulating the policies related to the contracts for producing a product. In legal terms, the main duty of the board is to direct the affairs of the organization but not to manage them. If the board of directors does not perform its responsibilities in the right manner and if it harms

the organization in any manner, then the directors can be held responsible for the harm that is caused by them.

- Section 291 of the Companies Act had specified some of the general powers of the board and they are as follows:
- According to the provisions of the Companies Act, the board of directors is allowed to exercise the following powers within the organization:
- The board will do only those things which are directed by the management of the organization. The board must also assist in doing the things that are not mentioned in the clause of the Companies Act.
- The organization will abide by the provisions that are in the Companies Act and will also follow the provisions that are formed in the general board meeting of the organization.
- The Company cannot make any regulations in the general meeting of an organization to invalidate any act of the board.

New trends of the board of directors in corporate governance

The board of directors plays a very important part in an organization. If a company possesses very good corporate governance and board of directors, then it will induce the investors to invest more in the organization. Investors are willing to invest more in an organization because good governance and the board of directors in an organization lead to better performance of the organization. Further, good governance reduces the chances of the organization falling into trouble. The various trends of the board of directors in corporate governance are as follows:

- There is more participation of the board not only in evaluating the performance of the company, but also in formulating the plans and policies of the organization.
- Institutional investors such as pension funds, mutual funds and insurance companies actively participate in the functioning of the board and they put pressure on the board to improve the performance of an organization.
- Non-management directors, which is not recognized in the eyes of law, are now actively participating in the board of an organization

- The number of the board members is reducing nowadays. This is because organizations prefer directors who have good knowledge and expertise rather those with general experience
- As more and more organizations operate their services globally, they look for board members who possess international experience.



Unit - 6: Marketing Management

- ✓ The Evolution of Marketing, Concept of Marketing, Marketing Mix, Marketing Tasks, Concepts and Tools, Marketing Environment
- ✓ Consumer Behaviour, Market Segmentation
- ✓ Product Decision
- ✓ Pricing Decisions
- ✓ Distribution Decision
- ✓ Promotion Decisions
- ✓ Marketing Planning, Organising and Controlling
- ✓ Marketing Research
- ✓ Online Marketing
- ✓ Direct Marketing: Social, Ethical and Legal Aspect of Marketing in India

Marketing Management

Marketing Environment and Environment Scanning

Marketing Environment



Definition: The **Marketing Environment** includes the Internal factors (employees, customers, shareholders, retailers & distributors, etc.) and the External factors (political, legal, social, technological, economic) that surround the business and influence its marketing operations.

Some of these factors are controllable while some are uncontrollable and require business operations to change accordingly. Firms must be well aware of its marketing environment in which it is operating to overcome the negative impact the environment factors are imposing on firm's marketing activities.

The marketing environment can be broadly classified into three parts:

1. **Internal Environment** – The Internal Marketing Environment includes all the factors that are within the organization and affects the overall business operations. These factors

include labor, inventory, company policy, logistics, budget, capital assets, etc. which are a part of the organization and affects the marketing decision and its relationship with the customers. These factors can be controlled by the firm.

2. **Microenvironment-** The Micro Marketing Environment includes all those factors that are closely associated with the operations of the business and influences its functioning. The microenvironment factors include customers, employees, suppliers, retailers & distributors, shareholders, Competitors, Government and General Public. These factors are controllable to some extent.

These factors are further elaborated:

- **Customers**– Every business revolves around fulfilling the **customer's needs and wants**. Thus, each marketing strategy is customer oriented that focuses on understanding the need of the customers and offering the best product that fulfills their needs.
- **Employees**– Employees are the main component of a business who contributes significantly to its success. The quality of employees depends on the training and motivation sessions given to them. Thus, **Training & Development** is crucial to impart marketing skills in an individual.
- **Suppliers**– Suppliers are the persons from whom the material is purchased to make a finished good and hence are very important for the organization. It is crucial to identify the suppliers existing in the market and choose the best that fulfills the firm's requirement.
- **Retailers & Distributors**– The channel partners play an imperative role in determining the success of marketing operations. Being in direct touch with customers they can give suggestions about customer's desires regarding a product and its services.
- **Competitors**– Keeping a close watch on competitors enables a company to design its marketing strategy according to the trend prevailing in the market.
- **Shareholders**– Shareholders are the owners of the company, and every firm has an objective of maximizing its shareholder's wealth. Thus, marketing activities should be undertaken keeping in mind the returns to shareholders.

- **Government**– The Government departments make several policies viz. Pricing policy, credit policy, education policy, housing policy, etc. that do have an influence on the marketing strategies. A company has to keep track on these policies and make the marketing programs accordingly.
 - **General public**– The business has some social responsibility towards the society in which it is operating. Thus, all the marketing activities should be designed that result in increased welfare of the society as a whole.
3. **Macro Environment**–The Macro Marketing Environment includes all those factors that exist outside the organization and can not be controlled. These factors majorly include Social, Economic, Technological Forces, Political and Legal Influences. These are also called as **PESTLE framework**.

The detailed description of Macro factors is given below:

- **Political & Legal Factors**– With the change in political parties, several changes are seen in the market in terms of trade, taxes, and duties, codes and practices, market regulations, etc. So the firm has to comply with all these changes and the violation of which could penalize its business operations.
- **Economic Factors**– Every business operates in the economy and is affected by the different phases it is undergoing. In the case of recession, the marketing practices should be different as what are followed during the inflation period.
- **Social Factors**– since business operates in a society and has some responsibility towards it must follow the marketing practices that do not harm the sentiments of people. Also, the companies are required to invest in the welfare of general people by constructing public conveniences, parks, sponsoring education, etc.
- **Technological Factors**– As technology is advancing day by day, the firms have to keep themselves updated so that customers needs can be met with more precision.

Therefore, marketing environment plays a crucial role in the operations of a business and must be reviewed on a regular basis to avoid any difficulty.

Environmental scanning is a part of SWOT Analysis. Environment scanning is a process in which the organization undertakes a study to identify the opportunities and threats in an industry. The information obtained through environmental scanning can be used by leaders to design new objectives and strategies or modify existing objectives and strategies. An organization must be agile in responding to environmental challenges while making most of the available opportunities.

The frequency of environmental scanning depends on the needs of the organization. An organization operating in an industry which is highly impacted by technological innovations needs to constantly monitor its environment and use the results to design its processes. On the other hand, some organizations might need to conduct an environmental scan on an ad-hoc basis.

In environmental scanning, the following areas need to be covered-

- Economic conditions
- Competition
- Global opportunities
- Employment trends
- Technological advancement
- Industry
- Geo-political climate



Hence, this concludes the definition of Environmental Scanning along with its overview.

Marketing Information System

The **Marketing Information System** refers to the systematic collection, analysis, interpretation, storage and dissemination of the market information, from both the internal and external sources, to the marketers on a regular, continuous basis.

The marketing information system distributes the relevant information to the marketers who can make the efficient decisions related to the marketing operations viz. Pricing, packaging, new product development, distribution, media, promotion, etc.

Every marketing operation works in unison with the conditions prevailing both inside and outside the organization, and, therefore, there are several sources (viz. Internal, Marketing Intelligence, Marketing Research) through which the relevant information about the market can be obtained.

Components of Marketing Information System



1. **Internal Records:** The Company can collect information through its internal records comprising of sales data, customer database, product database, financial data, operations data, etc. The detailed explanation of the internal sources of data is given below:

- The information can be collected from the documents such as invoices, transmit copies, billing documents prepared by the firms once they receive the order for the goods and services from the customers, dealers or the sales representatives.

- The current sales data should be maintained on a regular basis that serves as an aide to the Marketing Information System. The reports on current sales and the inventory levels help the management to decide on its objectives, and the marketers can make use of this information to design their future sales strategy.
- The Companies maintain several databases such as *Customer Database- wherein the complete information about the customer's name, address, phone number, the frequency of purchase, financial position, etc. is saved.
 1. *Product Database- wherein the complete information about the product's price, features, variants, is stored.
 2. *Salesperson database, wherein the complete information about the salesperson, his name, address, phone number, sales target, etc. is saved.



- The companies store their data in the data warehouse from where the data can be retrieved anytime the need arises. Once the data is stored, the statistical experts mine it by applying several computer software and techniques to convert it into meaningful information that gives facts and figures.



2. **Marketing Intelligence System:** The marketing intelligence system provides the data about the happenings in the market, i.e. data related to the marketing environment which is external to the organization. It includes the information about the changing market trends, competitor's pricing strategy, change in the customer's tastes and preferences, new products launched in the market, promotion strategy of the competitor, etc.

In order to have an efficient marketing Information System, the companies should work aggressively to improve the marketing intelligence system by taking the following steps:

- Providing the proper training and motivating the sales force to keep a check on the market trends, i.e. the change in the tastes and preferences of customers and give suggestions on the improvements, if any.
- Motivating the channel partners viz. Dealer, distributors, retailers who are in the actual market to provide the relevant and necessary information about the customers and the competitors.

- The companies can also improve their marketing intelligence system by getting more and more information about the competitors. This can be done either by purchasing the competitor's product, attending the trade shows, reading the competitor's published articles in magazines, journals, financial reports.
- The companies can have an efficient marketing information system by involving the loyal customers in the customer advisory panel who can share their experiences and give advice to the new potential customers.
- The companies can make use of the government data to improve its marketing Information system. The data can be related to the population trends, demographic characteristics, agricultural production, etc. that help an organization to plan its marketing operations accordingly.
- Also, the companies can purchase the information about the marketing environment from the research companies who carry out the researches on all the players in the market.
- The Marketing Intelligence system can be further improved by asking the customers directly about their experience with the product or service via feedback forms that can be filled online.



3. **Marketing Research:** The Marketing Research is the systematic collection, organization, analysis and interpretation of the primary or the secondary data to find out the solutions to the marketing problems. Several Companies conduct marketing research to analyze the marketing environment comprising of changes in the customer's tastes and preferences, competitor's strategies, the scope of new product launch, etc. by applying several statistical tools. In order to conduct the market research, the data is to be collected that can be either primary data (the first-hand data) or the secondary data (second-hand data, available in books, magazines, research reports, journals, etc.)

The secondary data are publicly available, but the primary data is to be collected by the researcher through certain methods such as questionnaires, personal interviews, surveys, seminars, etc. A marketing research contributes a lot in the marketing information system as it provides the factual data that has been tested several times by the researchers.

4. **Marketing Decision Support System:** It includes several software programs that can be used by the marketers to analyze the data, collected so far, to take better marketing decisions. With the use of computers, the marketing managers can save the huge data in a tabular form and can apply statistical programs to analyze the data and make the decisions in line with the findings.

Thus, the marketers need to keep a check on the marketing environment, i.e. both the internal (within the organization) and the external (outside the organization, so that marketing policies, procedures, strategies can be designed accordingly.

Marketing Research

The **Marketing Research** is the systematic collection, analysis, and interpretation of data pertaining to the marketing conditions.



The basic reason for carrying out the marketing research is to find out the change in the consumer behavior due to the change in the elements of the marketing mix (product, price, place, promotion).

The marketers need to know about the changing trends in the market viz. Changes in the customer's tastes and preferences, the new products launched in the market, prices of the competitor's product, the close substitutes of the product, etc.

Marketing Research Process

To begin with the marketing research, following steps has to be followed:

1. **Define the Problem**-The foremost decision that every firm has to undertake is to find out the problem for which the research is to be conducted. The problem must be defined adequately because if it is too vague, then it may result in the wastage of scarce resources and if it is too narrow, then the exact conclusion cannot be drawn. In order to define the problem appropriately, each firm must have a clear answer to the questions viz. What is to be researched (content and the scope)? And Why the research is to be done (decisions that are to be made)?

2. **Develop the Research Plan**– This step involves gathering the information relevant to the research objective. It includes:

- **Data Sources:** The researcher can collect the data pertaining to the research problem from either the primary source or the secondary source or both the sources of information. The primary source is the first-hand data that does not exist in any books or research reports whereas the secondary data is the second-hand data which is available in the books, journals, reports, etc.
- **Research Approaches:** The Secondary data are readily available in books, journals, magazines, reports, online, etc. But the primary data have to be collected and to do so, the following research can be conducted:
 1. **Observational Research:** The researcher can collect the information by just observing the happenings in the market and sometimes having a friendly conversation with the customers to know about their purchase experiences.
 2. **Ethnographic Research:** It is one of the forms of an observation research where the researcher studies an individual in the real life situation and not under any market setup or a lab. The purpose of this research is to know the way people live (their lifestyles), What they do to earn their livelihood, how they consume goods and services, what they need in their personal and professional lives etc.
 3. **Focus Group Research:** It is a form of group discussion wherein six to ten people gather and discuss the common topic given by the moderator. A moderator is a person who conducts the group discussion and is skilled in group dynamics. He also keeps the discussion focused on the topic so that relevant information can be obtained from the group members.
 4. **Survey Research:** These are the descriptive research generally conducted to know the about the customer's knowledge about the product, their preferences, and satisfaction level. The best way to conduct surveys is through the Questionnaires.
 5. **Behavioral Data:** The customer's actual purchases at the store reflects its behavior and the choice of products. Thus observing what customers are

buying gives more accurate information about the customer rather than the planned answers given by them in the surveys.

6. **Experimental research:** This is done to find out the cause and effect relationships. This research is undertaken to study the effects of change in the customer's behavior due to the change in the product's attributes.
- **Sampling plan:** Once the research approach is decided, the researcher has to design a sampling plan and have to decide on the following:
 1. The sampling Unit i.e. whom, shall we survey?
 2. The sample size, i.e., How many units in the population shall be surveyed?
 3. The sampling procedure, i.e. How the respondents shall be chosen?
- **Contact Methods:** The researcher has to choose the medium through which the respondents can be contacted. The respondents can be reached via emails, telephone, in person or online.



3. **Collect the Information:** This is one of the most expensive methods of marketing research. At this stage, the researcher has to adopt the methods to collect the information; he may find it difficult to gather the correct information because of the respondent's biasedness, unwillingness to give answers or not at home.
4. **Analyze the Information:** Once the information is collected the next step is to organize it in such a way that some analysis can be obtained. The researchers apply several statistical techniques to perform the analysis, such as they compute averages and measures of dispersion. Also, some advanced decision models are used to analyze the data.
5. **Present the Findings:** Finally, all the findings and the research are shown to the top management level viz. Managing director, CEO, or board of directors to make the marketing decisions in line with the research.
6. **Make the Decision:** This is the last step of the marketing research, once the findings are presented to the top level management it is up to them either to rely on the findings and take decisions or discard the findings as unsuitable.

Thus, marketing research is done to gather all the relevant information about the market and design the marketing strategies accordingly.

Types of Marketing Research

There are different types of marketing research classified on the basis of the research objective for which the study is to be carried out and the sources of data used to gather the information. The widely used classifications of marketing research is based on the functional objectives of the research and are identified as:

1. **Exploratory Market Research:** The researcher uses the exploratory research when he has a very little information about the research problem and needs to gain insights about it before finding the solutions to it. It requires the researcher to clear his concept, gain insights, formulate problems, eliminate impractical ideas and formulate a hypothesis to check the relevancy of the research design. This can be done by using the secondary data, i.e. information available both inside and outside the organization, conducting observational studies, consulting experts, and processing feedback from the marketplace and surveys.
2. **Descriptive Market Research:** The descriptive research is concerned with testing the hypothesis to find out the accurate answers of the research problem. Such as, who are the prospective buyers of the product?, How the products are consumed?, What fraction of the population uses the product?, What is the demand forecast? And who are the potential competitors? The objective of the descriptive market research is to measure the frequency with which the things occur and the extent to which the variables under study are correlated.
3. **Causal Market Research:** The causal market research is conducted to establish the cause-and-effect relationship between the variables, such as if the packaging of the product is changed then what will be its effect on the product durability? Thus, this research is carried out to explain the facts that why a certain change in one variable is observed due to the change in the other.
4. **Predictive Market Research:** As the name suggests, the predictive research is conducted to forecast or predict certain market variable for which the research is designed. Such as predicting the future sales, projection of growth, test market to predict the success of a new product, defining of firm's product line, etc.

The marketing research can be further classified on the basis of the type of data generated and the degree of mathematical accuracy required as:

- **Qualitative Market Research**
- **Quantitative Market Research**

Thus, there are several types of marketing research that an organization adopts on the basis of its pursued objectives and the form of data generated.

Understanding Consumer and Industrial Markets

Consumer market

Consumer is the end user – a user that consumes. Consumer is the uncrowned king of the market or the central point for which every marketing activity is integrated. Consumer or potential consumer (i. e. who can be consumer). Consumer market is the market for the consumers i. e. market of the products for final consumption. Understanding consumer market involves

1. Understanding of buying motives.
2. Understanding consumer behaviour.

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1. Understanding of buying motives.

Why consumers buy? To answer this question we can say in a line – for satisfaction of needs. But, there may be several kinds of motives for which consumers buy. Motivation is the driving force behind needs. Motive can be said as thought, urge, feeling, emotion and drive which make the buyer to react in the form of a decision. Motives can be classified as

- **Primary buying motives:** motives which are related to basic needs of human such as hunger, thirst, sleep, sex etc.. Due to these motives, people purchase several products.
- **Secondary buying motives :** motives which are influenced by the society or environment are said as secondary buying motives. They can be emotional like pride and prestige, love and affection, fear, curiosity etc.. They can also be rational like

utility, durability, economy, convenience et.. They can also be patronage motives like quality, service motive, store loyalty etc..

2. Understanding consumer behaviour. For understanding buying motives, we need to understand consumer behaviour. Consumer behaviour is the study of what, when, why, where and how people do or do not buy a product. There are many factors which affect consumer behaviour. Factors can be classified in four parts.

1. Cultural Factors. Consumer behavior is deeply influenced by cultural factors such as: culture, subculture, and social class.

(a) Culture. Culture is the part of every society and is the important cause of person's wants and behavior. The influence of culture on buying behavior varies from country to country therefore marketers have to be very careful in analyzing the culture of different groups, regions or even countries.

(b) Subculture. Each culture contains different subcultures such as religions, nationalities, geographic regions, racial groups etc. Marketers can use these groups by segmenting the market into various small portions. For example marketers can design products according to the needs of a particular geographic group.

(c) Social Class. Every society possesses some form of social class which is important to the marketers because the buying behavior of people in a given social class is similar. In this way marketing activities could be tailored according to different social classes. Here we should note that social class is not only determined by income but there are various other factors as well such as: wealth, education, occupation etc.

2. Social Factors. Social factors also impact the buying behavior of consumers. The important social factors are: reference groups, family, role and status.

a) Reference Groups-Reference groups have potential in forming a person attitude or behavior. The impact of reference groups varies across products and brands. For example if the product is visible such as dress, shoes, car etc then the influence of reference groups will be high. Reference groups also include opinion leader (a person who influences other because of his special skill, knowledge or other characteristics).

- b) Family - Buyer behavior is strongly influenced by the member of a family. Therefore marketers are trying to find the roles and influence of the husband, wife and children. If the buying decision of a particular product is influenced by wife then the marketers will try to target the women in their advertisement. Here we should note that buying roles change with change in consumer lifestyles.
- c) Roles and Status - Each person possesses different roles and status in the society depending upon the groups, clubs, family, organization etc. to which he belongs. For example a woman is working in an organization as finance manager. Now she is playing two roles, one of finance manager and other of mother. Therefore her buying decisions will be influenced by her role and status.

3. Personal Factors - Personal factors can also affect the consumer behavior. Some of the important personal factors that influence the buying behavior are: lifestyle, economic situation, occupation, age, personality and self-concept.

- a. Age - Age and life-cycle have potential impact on the consumer buying behavior. It is obvious that the consumers change the purchase of goods and services with the passage of time. Family life-cycle consists of different stages such young singles, married couples, unmarried couples etc which help marketers to develop appropriate products for each stage.
- b. Occupation - The occupation of a person has significant impact on his buying behavior. For example a marketing manager of an organization will try to purchase business suits, whereas a low level worker in the same organization will purchase rugged work clothes.
- c. Economic Situation - Consumer economic situation has great influence on his buying behavior. If the income and savings of a customer is high then he will purchase more expensive products. On the other hand, a person with low income and savings will purchase inexpensive products.
- d. Lifestyle - Lifestyle of customers is another import factor affecting the consumer buying behavior. Lifestyle refers to the way a person lives in a society and is expressed by the things in his/her surroundings. It is determined by customer

interests, opinions, activities etc and shapes his whole pattern of acting and interacting in the world.

- e. Personality - Personality changes from person to person, time to time and place to place. Therefore it can greatly influence the buying behavior of customers. Actually, Personality is not what one wears; rather it is the totality of behavior of a man in different circumstances. It has different characteristics such as: dominance, aggressiveness, self-confidence etc which can be useful to determine the consumer behavior for particular product or service.

4. Psychological Factors - There are four important psychological factors affecting the consumer buying behavior. These are: perception, motivation, learning, beliefs and attitudes.

- (a) Motivation - The level of motivation also affects the buying behavior of customers. Every person has different needs such as physiological needs, biological needs, social needs etc. The nature of the needs is that, some of them are most pressing while others are least pressing. Therefore a need becomes a motive when it is more pressing to direct the person to seek satisfaction.

- (b) Perception - Selecting, organizing and interpreting information in a way to produce a meaningful experience of the world is called perception. There are three different perceptual processes which are selective attention, selective distortion and selective retention. In case of selective attention, marketers try to attract the customer attention. Whereas, in case of selective distortion, customers try to interpret the information in a way that will support what the customers already believe. Similarly, in case of selective retention, marketers try to retain information that supports their beliefs.

- (c) Beliefs and Attitudes - Customer possesses specific belief and attitude towards various products. Since such beliefs and attitudes make up brand image and affect consumer buying behavior therefore marketers are interested in them. Marketers can change the beliefs and attitudes of customers by launching special campaigns in this regard.

Industrial marketing and buying

Industrial marketing is the marketing of goods and services by one business to another. Industrial goods are those an industry uses to produce an end product from one or more raw materials.

Industrial buying is more rational and less emotional compared to consumer buying. Another way of expression is Organizational or industrial buying is the decisions making process, by which formal organizations establish the need for purchased products and services and identify, evaluate and choose among alternative brands and supplies.

There are two important issues to consider.

- a. the customer decision-making process
- b. the influences on customers' decision-making.

By understanding both the processes involved in customers' buying decision making and the influences on these processes, marketers can more effectively use the marketing mix to influence customers.

Buying situations in industrial buying



There are mainly three types of industrial buying situations.

- Straight rebuy. In straight rebuy, the purchasing department reorders on a routine basis.
- Modified rebuy. In modified rebuy, the buyer wants to modify product specifications, prices, delivery requirements or other terms.
- New task. In new task buying, a purchaser buys a product or service for the first time.

Participants in the industrial buying process

Participants in the industrial buying process includes following.

1. Initiators.
2. Users.
3. Influencers.
4. Decision makers.
5. Approving bodies.
6. Buyers.
7. Gatekeepers.

The industrial buying process

The industrial buying process involves following steps.

1. Problem recognition.
2. General need description.
3. Product specifications.
4. Supplier search.
5. Proposal solicitation.
6. Supplier selection.
7. Order routine specifications.
8. Performance review.



Factors influencing industrial buying.

Factors influencing industrial buying can be classified in four categories.

1. Environmental factors.
2. Organizational factors.
3. Interpersonal factors.
4. Individual factors.

Demand Measurement and Forecasting

One major reason for market research is for a company to identify marketing opportunities. Following the completion of research, companies must measure and forecast the size, growth potential and business potential of each opportunity. Sales forecasts are used company-wide for production scheduling and planning and allocation of resources. Demand and sales forecasting are a marketing activity. Inaccurate sales forecasts can lead to either excess inventory or inventory shortfall, neither of which is good for the organisation. Before we look at forecasting methodologies, it is important to understand some terminology first:

1. Market demand, market potential and market penetration

Market demand for a product is the total volume that would be bought by a defined customer group, in a given territory, time period and under certain environmental conditions. Given a change in any of the variables, the demand estimate would also change. Market demand is often referred to as market demand function and its levels would vary between the market minimum and market potential. Market minimum is the base level of sales that would take place without any specific marketing program in place. Creating specific marketing programs to at an increasing rate and then beyond a level at a decreasing rate. Beyond a point, increasing marketing expenditures will not lead to any increase in sales as the market has reached saturation point. This upper limit to the market demand is known as market potential. Between the two levels of market minimum and market potential exists the opportunity for the company to stimulate the market demand.

2. Company demand, sales forecast and sales potential

Company demand is the company's estimated share of the market demand, at different levels of marketing efforts in a given time period. The company's share of demand will depend on how its products, services, prices and communications are perceived relative to competitors. Other things being equal, the size and effectiveness of a company's marketing expenditures relative to its competitors will determine the company's market share. Several mathematical

sales response models have been created to measure how a company's sales will be affected by size of marketing spend, marketing mix and effectiveness of marketing programs.

In relation to company sales forecasts companies set sales targets and create sales budgets. Sales budgets are realistic, conservative estimates of the expected volume of sales and are used mainly for resource planning, productions and purchasing scheduling and cash flow planning. Sales targets on the other hand are goals set for managers, product lines and divisions and mainly as motivational tools to stretch the managerial effort. Sales targets are usually higher estimates of sales forecasts.

3. Estimating current demand

Marketing executive's first need is to estimate the total market potential, area market potential, total industry sales and market shares. Total market potential: is the maximum amount of sales available to all firms in an industry during a given time period, marketing effort and environmental conditions. A common way to estimate the total market potential is to estimate the total number of potential buyer's average quantity per buyer price.

Area market potential: companies need to assess the market potential of different territories, for optimal allocation of resources to the different territories. Two major methods available are the market buildup method and multiple factor index method. The market build up method calls for identifying all potential buyers in each market and estimating their potential purchases. This method produces results if one has a list of potential buyers and a good estimate of what each one will buy.

4. Estimating future demand

Very few products or services lend themselves to easy forecasting; only in categories where demand is fairly, competition is nonexistent or oligopolies is forecasting a relatively straight forward exercise. Companies use both "top down" and bottom up" approaches to prepare sales forecast. The top down approach would be done in three stages. The first stage is a macro-economic forecast which calls for projecting inflation, interest rates, consumer spending, increasing in per capita and disposable income and other economic variables.

Survey of buyer's intentions: Company's commission research organisations conduct periodic surveys of consumer buying intentions.

Composite of sales force: sales representatives in different territories develop estimates of how much each current and prospective customer will buy of the company's products. The figures estimated are usually adjusted for the company's marketing plans in a given territory that could influence sales. Since sales reps have better knowledge of the potential of their territories, such forecasts can be helpful in developing more accurate estimates of sales.

Expert opinions from industry associations and surveys of dealers, distributors and suppliers are regularly used to forecast short term demand. Surveys of dealers, distributors and retailers have their strengths and weaknesses, but can yield rich information on short term demand within territories.

Market Segmentation

Market Segmentation is a process of dividing the market of potential customers into different groups and segments on the basis of certain characteristics. The member of these groups share similar characteristics and usually have one or more than one aspect common among them.



There are many reasons as to why market segmentation is done. One of the major reasons marketers segment market is because they can create custom [marketing mix](#) for each segment and cater them accordingly. The concept of market segmentation was coined by Wendell R. Smith who in his article “Product Differentiation and Market Segmentation as Alternative Marketing Strategies” observed “many examples of segmentation” in 1956. Present-day market segmentation exists basically to solve one major problem of marketers; more conversions. More conversion is possible through personalized marketing campaigns which require marketers to segment market and draft better product and communication strategies according to needs of the segment.

Basis of Market Segmentation

Segmenting is dividing a group into subgroups according to some set 'basis'. These bases range from age, gender, etc. to psychographic factors like attitude, interest, values, etc.

Gender

Gender is one of the most simple yet important basis of market segmentation. The interests, needs and wants of males and females differ at many levels. Thus, marketers focus on different marketing and communication strategies for both. This type of segmentation is usually seen in the case of cosmetics, clothing, and jewellery industry, etc.

Age group

Segmenting market according to the age group of the audience is a great strategy for personalized marketing. Most of the products in the market are not universal to be used by all the age groups. Hence, by segmenting the market according to the target age group, marketers create better marketing and communication strategies and get better conversion rates.

Income



Income decides the purchasing power of the target audience. It is also one of the key factors to decide whether to market the product as a need, want or a luxury. Marketers usually segment the market into three different groups considering their income. These are

- High Income Group
- Mid Income Group
- Low Income Group

This division also varies according to the product, its use, and the area the business is operating in.

Place

The place where the target audience lives affects the buying decision the most. A person living on mountains will have less or no demand for ice cream than the person living in a desert.

Occupation

Occupation, just like income, influences the purchase decision of the audience. A need for an [entrepreneur](#) might be a luxury for a government sector employee. There are even many products which cater to an audience engaged in a specific occupation.

Usage

Product usage also acts as a segmenting basis. A user can be labelled as heavy, medium or light user of a product. The audience can also be segmented on the basis of their awareness of the product.

Lifestyle

Other than physical factors, marketers also segment the market on the basis of lifestyle. Lifestyle includes subsets like marital status, interests, hobbies, religion, values, and other psychographic factors which affect the decision making of an individual.

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Types of Market Segmentation

Geographic Segmentation

Geographic segmentation divides the market on the basis of geography. This type of market segmentation is important for the marketers as people belonging to different regions may have different requirements. For example, water might be scarce in some regions which inflates the demand for bottled water but, at the same time, it might be in abundance in other regions where the demand for the same is very less.

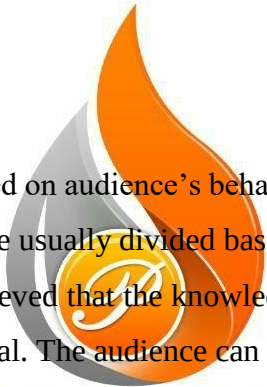
People belonging to different regions may have different reasons to use the same product as well. Geographic segmentation helps marketer draft personalized marketing campaigns for everyone.

Demographic Segmentation

Demographic segmentation divides the market on the basis of demographic variables like age, gender, marital status, family size, income, religion, race, occupation, nationality, etc. This is one of the most common segmentation practice among the marketers. Demographic segmentation is seen almost in every industry like automobiles, beauty products, mobile phones, apparels, etc and is set on a premise that the customers' buying behaviour is hugely influenced by their demographics.

Behavioral Segmentation

The market is also segmented based on audience's behaviour, usage, preference, choices and decision making. The segments are usually divided based on their knowledge of the product and usage of the product. It is believed that the knowledge of the product and its use affects the buying decision of an individual. The audience can be segmented into –

- 
- Those who know about the product,
 - Those who don't know about the product,
 - Ex-users,
 - Potential users,
 - Current Users,
 - First time users, etc.

People can be labelled as brand loyal, brand-neutral, or competitor loyal. They can also be labelled according to their usage. For example, a sports person may prefer an energy drink as elementary (heavy user) and a not so sporty person may buy it just because he likes the taste (light/medium user).

Psychographic Segmentation

Psychographic Segmentation divides the audience on the basis of their personality, lifestyle and attitude. This segmentation process works on a premise that consumer buying behaviour can be influenced by his personality and lifestyle. Personality is the combination of characteristics that form an individual's distinctive character and includes habits, traits, attitude, temperament, etc. Lifestyle is how a person lives his life.

Personality and lifestyle influence the buying decision and habits of a person to a great extent. A person having a lavish lifestyle may consider having an air conditioner in every room as a need, whereas a person living in the same city but having a conservative lifestyle may consider it as a luxury.

Nature of a market segment

A market segment needs to be **homogeneous**. There should be something common among the individuals of the segment that the marketer can capitalise on. Marketers also need to check that different segments have different distinguishing features which make them **unique**. But segmenting requires more than just similar features. Marketers must also ensure that the individuals of the segment **respond in a similar way** to the stimulus. That is, the segment must have a similar type of reaction to the marketing activities being pitched.

A good market segment is always *externally heterogeneous and internally homogeneous*.



Examples of market segmentation

Market segmentation is a common practice among all the industries. It is not possible for a marketer to address the mass with same marketing strategy. Here are some examples of market segmentation to prove this point.

- Marketers will only waste their time and might end up making fun of themselves if they don't segment the market while marketing beauty products.
- A company that sells nutritious food might market the product to the older people while fast-food chains target the working demographic or teens.

- Sports brands often segment the market based on the sports they play which help them market the sports specific products to the right audience.

Market Segmentation is a convenient method marketers use to cut costs and boost their conversions. It allows them to be specific in their planning and thus provide better results. It ultimately helps them to target the niche user base by making smaller segments.

Market Targeting

This is the evaluation of the various segments identified during segmentation and deciding how many and which ones to serve.

Evaluating The Market Segments

In evaluating different market segments, the firm must look at the following factors

1) Segment size and growth

- Marketing segment has to be 'right size'. Size can be measured in terms of sales volume.
- Companies should not only concentrate on sales volume but also on the growth potential of the segment.



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2) Segments structural attractiveness – Using Porter's Five Forces Analysis.

A segment might have desirable size and growth characteristics and still not profitable.

The company should evaluate the long-run profitability of the market segment.

Michael Porter has identified five forces that determine the intensive long-run attractiveness of the whole market or any other segment within it. These five forces are:-

- Threat of intense segment rivalry -A segment is unattractive if it already contains strong or aggressive competitors.

- Threat of new entrants -A segment is unattractive if it is likely to attract new competitors who will bring in new capacity, substantial resources and a drive for market share growth.
 - Threats of substitute products -A segment is unattractive if there exists actual or potential substitutes for the product.
 - Threats of growing bargaining powers of buyers -A segment is unattractive if the buyer's possesses strong or increasing bargaining power. Interested in low prices but high quality.
 - Threat of growing bargaining power and suppliers -A segment is unattractive if the suppliers possess a strong or increasing bargaining power. They can raise prices or reduce the quality and quantity of products and services offered.
- Even if the segment has positive size and growth and it is attractive, the company has to consider its own objectives and resources.
 - The segment can be dismissed because it does not fit in the company's long-run objectives.
 - Even if segments fit the company's objectives, it must consider whether it has the required skills and resources to succeed in that segment.
- 3) Segment interrelationships

Segments selected should be inter-related in terms of costs, performance and technology for effectiveness.

Target Market Strategies

There are several different target-market strategies that may be followed. Targeting strategies usually can be categorized as one of the following:

Single-segment strategy - also known as a concentrated strategy. One market segment (not the entire market) is served with one marketing mix. A single-segment approach often is the strategy of choice for smaller companies with limited resources.

Selective specialization- this is a multiple-segment strategy, also known as a differentiated strategy. Different marketing mixes are offered to different segments. The product itself may or may not be different - in many cases only the promotional message or distribution channels vary.

Product specialization- the firm specializes in a particular product and tailors it to different market segments.

Market specialization- the firm specializes in serving a particular market segment and offers that segment an array of different products.

Full market coverage - the firm attempts to serve the entire market. This coverage can be achieved by means of either a mass market strategy in which a single undifferentiated marketing mix is offered to the entire market, or by a differentiated strategy in which a separate marketing mix is offered to each segment.

Undifferentiated marketing strategy

Differentiated marketing



With differentiated or multi-segment approach, the marketer targets a variety of different segments with a series of differentiated products. This is typical in the motor industry which has a variety of products such as diesel, four-wheel-drive, sports saloons, and so on.

A firm that is seeking to enter a market and grow should first target the most attractive segment that matches its capabilities. Once it gains a foothold, it can expand by pursuing a product specialization strategy, tailoring the product for different segments, or by pursuing a market specialization strategy and offering new products to its existing market segment.

Another strategy whose use is increasing is individual marketing, in which the marketing mix is tailored on an individual consumer basis. While in the past impractical, individual marketing is becoming more viable thanks to advances in technology.

Market Positioning

This is the act of designing a company's offering and image to occupy a distinctive place in the target market's mind. I.e. The act of creating a difference between a company's offer from those of competitors.

Positioning is the process of establishing and maintaining a distinctive place in the market for the organizations' product or brands. Positioning starts with the product, but positioning is not what you do to a product. Positioning is what you do to the mind of the customer. You should concentrate on the perception of the customer and not the reality of the product. Positioning then is how the product is perceived and evaluated by the target market, relative to competing products. To the consumer perception is reality. That is why it is said that a marketing battle is fought in the minds of consumers. Marketers who attain a superior position in customers' minds have won the marketing battle.

A difference is worth establishing to the extent that it satisfies the following criteria.

- 
1. Important: - The difference delivers a highly valued benefit to a sufficient number of buyers.
 2. Distinctive:- The difference is delivered in a distinctive way
 3. Superior: The difference is superior to other ways of obtaining the benefit.
 4. Pre-emptive: The difference cannot be easily copied by competitors.
 5. Affordable - The buyer can afford to pay for the difference.
 6. Profitable - The Company will find it profitable to introduce the difference.

Positioning strategies:-

- Attribute positioning -A company positions itself on an attribute e.g. size, number of years in existence.
- Benefit positioning -The product is positioned as the leader in a certain benefit.
- Use or application positioning -Positioning a product as the best for some use or application.

- User positioning -Positioning a product the best for some user group e.g. Bic pen, food for consumption.
- Competitor positioning -The product claims to be better in some way than a named competitor.
- Product category positioning -The product is positioned as the leader in a certain product category
- Quality or price positioning. -The product is positioned as offering the best value

As companies increase their number of claims for their brands, they risk disbelief and loss of clear positioning. Companies must avoid four major positioning errors.

- Under Positioning -When buyers have only a vague idea of the brand
- The brand is seen as just another entry in a crowded marketplace. E.g. When Pepsi introduced its clear crystal Pepsi in 1993 (U.S.A.) customers were distinctively unimpressed. They didn't see 'clarity' as an important benefit of a soft drink.
- Over Positioning -Buyers may have too narrow a image of the brand. These buyers might think that suits at Sir Henry's start at 15000/= when in fact it offers affordable suits started at 3000/=
- Confused Positioning -Buyers might have a confused image of the brand resulting from the company making too many claims or changing the brands positioning too frequently e.g. Omo, Zain
- Doubtful Positioning -Buyers might find it hard to believe the brand claims in view of the products features, price or manufacturers.

The Marketing Mix 4P's and 7P's

The **marketing mix definition** is simple. It is about putting the right product or a combination thereof in the place, at the right time, and at the right price. The difficult part is doing this well, as you need to know every aspect of your business plan.

Marketing Mix 4P's

A marketing expert named E. Jerome McCarthy created the Marketing 4Ps in the 1960s. This classification has been used throughout the world. Business schools teach this concept in basic marketing classes.

The marketing 4Ps are also the foundation of the idea of marketing mix.

#1 Marketing Mix – Product

A product is an item that is built or produced to satisfy the needs of a certain group of people. The product can be intangible or tangible as it can be in the form of services or goods.

You must ensure to have the right type of product that is in demand for your market. So during the product development phase, the marketer must do an extensive research on the life cycle of the product that they are creating. A product has a certain life cycle that includes the growth phase, the maturity phase, and the sales decline phase. It is important for marketers to reinvent their products to stimulate more demand once it reaches the sales decline phase.

Marketers must also create the right product mix. It may be wise to expand your current product mix by diversifying and increasing the depth of your product line. All in all, marketers must ask themselves the question “what can I do to offer a better product to this group of people than my competitors”.

In developing the right product, you have to answer the following questions:

- What does the client want from the service or product?
- How will the customer use it?
- Where will the client use it?
- What features must the product have to meet the client's needs?
- Are there any necessary features that you missed out?
- Are you creating features that are not needed by the client?
- What's the name of the product?
- Does it have a catchy name?

- What are the sizes or colors available?
- How is the product different from the products of your competitors?
- What does the product look like?

#2 Marketing Mix – Price

The price of the product is basically the amount that a customer pays for to enjoy it. Price is a very important component of the **marketing mix definition**. It is also a very important component of a marketing plan as it determines your firm's profit and survival. Adjusting the price of the product has a big impact on the entire marketing strategy as well as greatly affecting the sales and demand of the product.

This is inherently a touchy area though. If a company is new to the market and has not made a name for themselves yet, it is unlikely that your target market will be willing to pay a high price.

Although they may be willing in the future to hand over large sums of money, it is inevitably harder to get them to do so during the birth of a business. Pricing always help shape the perception of your product in consumers eyes. Always remember that a low price usually means an inferior good in the consumers eyes as they compare your good to a competitor.

Consequently, prices too high will make the costs outweigh the benefits in customers eyes, and they will therefore value their money over your product. Be sure to examine competitors pricing and price accordingly. When setting the product price, marketers should consider the perceived value that the product offers. There are three major pricing strategies, and these are:

- Market penetration pricing
- Market skimming pricing
- Neutral pricing

Here are some of the important questions that you should ask yourself when you are setting the product price:

- How much did it cost you to produce the product?
- What is the customers' perceived product value?
- Do you think that the slight price decrease could significantly increase your market share?
- Can the current price of the product keep up with the price of the product's competitors?

#3 Marketing Mix – Place

Placement or distribution is a very important part of the product mix definition. You have to position and distribute the product in a place that is accessible to potential buyers. This comes with a deep understanding of your target market. Understand them inside out and you will discover the most efficient positioning and distribution channels that directly speak with your market.

There are many distribution strategies, including:

- Intensive distribution
- Exclusive distribution
- Selective distribution
- Franchising



Here are some of the questions that you should answer in developing your distribution strategy:

- Where do your clients look for your service or product?
- What kind of stores do potential clients go to? Do they shop in a mall, in a regular brick and mortar store, in the supermarket, or online?
- How do you access the different distribution channels?
- How is your distribution strategy different from your competitors?
- Do you need a strong sales force?
- Do you need to attend trade fairs?
- Do you need to sell in an online store?

#4 Marketing Mix – Promotion

Promotion is a very important component of marketing as it can boost brand recognition and sales. Promotion is comprised of various elements like:

- Sales Organization
- Public Relations
- Advertising
- Sales Promotion

Advertising typically covers communication methods that are paid for like television advertisements, radio commercials, print media, and internet advertisements. In contemporary times, there seems to be a shift in focus offline to the online world. Public relations, on the other hand, are communications that are typically not paid for. This includes press releases, exhibitions, sponsorship deals, seminars, conferences, and events.

Word of mouth is also a type of product promotion. Word of mouth is an informal communication about the benefits of the product by satisfied customers and ordinary individuals. The sales staff plays a very important role in public relations and word of mouth.

It is important to not take this literally. Word of mouth can also circulate on the internet. Harnessed effectively and it has the potential to be one of the most valuable assets you have in boosting your profits online. An extremely good example of this is online social media and managing a firm's online social media presence.

In creating an effective product promotion strategy, you need to answer the following questions:

- How can you send marketing messages to your potential buyers?
- When is the best time to promote your product?
- Will you reach your potential audience and buyers through television ads?
- Is it best to use the social media in promoting the product?
- What is the promotion strategy of your competitors?

Your combination of promotional strategies and how you go about promotion will depend on your budget, the message you want to communicate, and the target market you have defined already in previous steps.

Marketing Mix 7P's

#5 Marketing Mix – People

Thorough research is important to discover whether there are enough people in your target market that is in demand for certain types of products and services. The company's employees are important in marketing because they are the ones who deliver the service. It is important to hire and train the right people to deliver superior service to the clients, whether they run a support desk, customer service, copywriters, programmers...etc.

When a business finds people who genuinely believe in the products or services that the particular business creates, it's highly likely that the employees will perform the best they can.

Additionally, they'll be more open to honest feedback about the business and input their own thoughts and passions which can scale and grow the business. This is a secret, "internal" competitive advantage a business can have over other competitors which can inherently affect a business's position in the marketplace.

#6 Marketing Mix – Process

The systems and processes of the organization affect the execution of the service. So, you have to make sure that you have a well-tailored process in place to minimize costs. It could be your entire sales funnel, a pay system, distribution system and other systematic procedures and steps to ensure a working business that is running effectively. Tweaking and enhancements can come later to "tighten up" a business to minimize costs and maximise profits.

#7 Marketing Mix – Physical Evidence

In the service industries, there should be physical evidence that the service was delivered. Additionally, physical evidence pertains also to how a business and its products are perceived in the marketplace. It is the physical evidence of a business' presence and establishment. A concept of this is branding. For example, when you think of "fast food", you think of McDonalds.

When you think of sports, the names Nike and Adidas come to mind. You immediately know exactly what their presence is in the marketplace, as they are generally market leaders and have established a physical evidence as well as psychological evidence in their marketing.

They have manipulated their consumer perception so well to the point where their brands appear first in line when an individual is asked to broadly "name a brand" in their niche or industry.

Marketing Mix 4C's

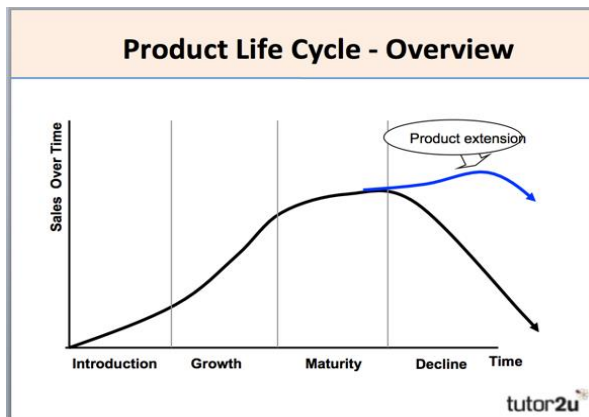
The 4Cs marketing model was developed by Robert F. Lauterborn in 1990. It is a modification of the 4Ps model. It is not a basic part of the **marketing mix definition**, but rather an extension. Here are the components of this marketing model:

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- Cost – According to Lauterborn, price is not the only cost incurred when purchasing a product. Cost of conscience or opportunity cost is also part of the cost of product ownership.
- Consumer Wants and Needs – A company should only sell a product that addresses consumer demand. So, marketers and business researchers should carefully study the consumer wants and needs.
- Communication – According to Lauterborn, "promotion" is manipulative while communication is "cooperative". Marketers should aim to create an open dialogue with potential clients based on their needs and wants.
- Convenience – The product should be readily available to the consumers. Marketers should strategically place the products in several visible distribution points.

Product Life Cycle

- The main stages of the product life cycle are:
- **Introduction** – researching, developing and then launching the product
- **Growth** – when sales are increasing at their fastest rate
- **Maturity** – sales are near their highest, but the rate of growth is slowing down, e.g. new competitors in market or saturation
- **Decline** – final stage of the cycle, when sales begin to fall
- This can be illustrated by looking at the sales during the time period of the product.



Extending the Product Life Cycle

What can businesses do to extend the product life cycle?

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1. **Extension strategies** extend the life of the product before it goes into decline. Again businesses use marketing techniques to improve sales. Examples of the techniques are:
2. **Advertising** – try to gain a new audience or remind the current audience
3. **Price reduction** – more attractive to customers
4. **Adding value** – add new features to the current product, e.g. improving the specifications on a smartphone
5. **Explore new markets** – selling the product into new geographical areas or creating a version targeted at different segments
6. **New packaging** – brightening up old packaging or subtle changes

New Product Development

Idea Generation

The first stage of the New Product Development is the idea generation. Ideas come from everywhere, can be of any form, and can be numerous. This stage involves creating a large pool of ideas from various sources, which include

- **Internal sources** – many companies give incentives to their employees to come up with workable ideas.
- **SWOT analysis** – Company may review its strength, weakness, opportunities and threats and come up with a good feasible idea.
- **Market research** – Companies constantly reviews the changing needs, wants, and trends in the market.
- **Customers** – Sometimes reviews and feedbacks from the customers or even their ideas can help companies generate new product ideas.
- **Competition** – Competitors SWOT analysis can help the company generate ideas.

Idea Screening

Ideas can be many, but good ideas are few. This second step of new product development involves finding those good and feasible ideas and discarding those which aren't. Many factors play a part here, these include

- Company's strength,
- Company's weakness,
- Customer needs,
- Ongoing trends,
- Expected ROI,
- Affordability, etc.

Concept Development & Testing

The third step of the new product development includes concept development and testing. A concept is a detailed strategy or blueprint version of the idea. Basically, when an idea is



developed in every aspect so as to make it presentable, it is called a concept. All the ideas that pass the screening stage are turned into concepts for testing purpose. You don't want to launch a product without its concept being tested, right? The concept is now brought to the target market. Some selected customers from the target group are chosen to test the concept. Information is provided to them to help them visualize the product. It is followed by questions from both sides. Business tries to know what the customer feels of the concept. Does the product fulfil customer's need or want? Will they buy it when it's actually launched?

Their feedback helps the business to develop the concept further.

Business Strategy Analysis & Development

The testing results help the business in coming up with the final concept to be developed into a product. Now that the business has a finalized concept, it's time for it to analyse and decide the marketing and other business strategies that will be used. Estimated product profitability is estimated, marketing mix, and branding strategies are decided for the product.

- Competition of the product
- Costs involved
- Pricing strategies
- Breakeven point, etc.



Product Development

Once all the strategies are approved, the product concept is transformed into an actual tangible product. This development stage of New Product Development results in building up of a prototype or a limited production model. All the branding and other strategies decided previously are tested and applied in this stage.

Test Marketing

Unlike concept testing, here the actual prototype is introduced for research and feedback. Actual customers feedback are taken and further changes, if required, are made to the product.

This process is of utmost importance as it validates the whole concept and makes the company ready for the launch.

Commercialization

The product is ready, so should be the marketing strategies. The marketing mix is now put to use. The final decisions are to be made. Markets are decided for the product to launch in. This stage involves briefing different departments about the duties and targets. Every minor and major decision is made before the final introduction stage of the New Product Development.

Branding and Packaging

What is Branding?

Branding is all of the ways you establish an image of your company in your customers' eyes.

By building a website that describes what you offer, designing ads that promote your goods and services, selecting specific corporate colors that will be associated with your company, creating a logo, and featuring it across all your social media accounts, you are branding your company. That is, you are shaping how and what people's perceptions of your business are. And what your customers say about your brand is the reality (not what you'd like them to think). It's the impression that pops into their minds when they hear your business' name. It's based on a feeling they have that is based on their experiences they've had with you, good or bad.

What's the Point?

The purpose of branding is to simply and easily help your customers understand what you offer and how you're different. But it's not only a USP (unique selling proposition), it is the combination of all the ways you communicate what you stand for. In addition to your logo and corporate colors, you can communicate your brand message through:

- Your store environment and atmosphere
- How your staff members treat customers

- How your staff members dress
- The products you carry
- The price you charge
- Product packaging
- Public relations
- Public speaking
- Direct mail
- Sponsorships
- Advertising
- Nonprofit partnerships

Building a Brand

If your business does not yet have a consistent brand, or you don't like what your brand currently stands for, it's time to rebrand. Here are some steps to take to shape public perception for the better:



- Identify what your customers love most about your business. What makes yours stand out? What are your strengths?
- Create a brand message that conveys what your business aims to do for its customers – what you're best at. Geico promises to save you 15% in 15 minutes. That's its brand promise. Marriott promises quiet luxury. What are you promising your customers? And are you delivering?
- Make sure your visual elements match your message, and your brand. If you're promising innovation, don't use greys and boring images.
- Develop standards for employee dress and behavior that support your brand promise. Make sure they understand what your brand is and can support it.
- Apply your visuals across every marketing tool you use, from advertising to signage to store displays to mailings to shopping bags.

Branding is a complex process, mainly because its success or failure is determined by your customers' reactions to the act of doing business with you.

Packaging

Packaging is the activity of designing and producing the container or wrapper for the product. It is an important and effective sales tool for encouraging the consumers for buying. It is powerful medium for sales promotion. It must perform all the basic function such as protection, ease of handling and storage, convenience in usage etc. and should not be deceptive and convey any deceptive message. It is the best method for attracting the consumers for buying the products.

According to W.J.Stanton, “Packaging may be defined as the general group of activities in product planning which helps in value designing and producing the container or wrapper for a product.”

According to Pride and Farell, “Packaging involves the development of container and a graphic design for a product.”

Functions of Packaging

Packaging should serve the following basic functions:

- **Protects the contents:**

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The basic function of packaging is to protect the contents from damage, dust, dirt, leakage, pilferage, evaporation, watering, contamination and so on. Packaging helps in the protection of the contents of the products. Seasonal fluctuations in demand may be smoothed out through packaging. Packaging helps to protect the contents of all the available products.

- **Provides product density:**

Packaging helps to provide product density. It implies selecting such package materials, design, and shape that helps to use the limited space in the best way. It improves relations with common carriers, permits better use of space in storage and usage and increases the grace and poise of arrangement.

- **Act as promotional tool:**

Good packaging can sell the product more easily and quickly as it works as a promotional tool. As a promotional tool, it does self-advertising, displaying, publishing and acts as an advertising medium. It is the package, size, design, color combinations and graphics that decide its ability to attract the valuable attention of customers or the prospects.

- **Provides user convenience:**

Packaging helps to provide the user convenience. The good packaging does this in a greater degree. As a result, the marketing functions of the transportation, storage, and handling are performed with ease and without wastage. Consumers are greatly assisted so long as the product is in usage. Neat packaging has brought a home reduction in inventory costs, packaging costs, space and time costs.

- **Facilitates product identification:**

Packaging helps to facilitate the identification of the product. This process of product differentiation is furthered by effective product identifiers; one is branding and another is packaging. The product package identifies the product no matter where you see it, under what circumstances you see it, or when you see it. A package is product's personality, its reality. Product identification goes easy with distinguished packaging as it adds to its personality or image.

- **Allows easy product mix:**

Product mix relates to the product lines and an assortment of sizes, colors, measures, grades, package types etc. offered by the selling house. Change in product mix can be possible as packaging helps to influence weight, size, and dimensions of the product. Packaging helps to allow the product mix easily for the consumers.

[Importance of Packaging](#)

The importance of packaging are as follows:

- **Creation of demand:**

Packaging plays an important role in the creation of demand by attracting the consumers. The customers become known with the product through advertising. It helps to increase the demand of the customers.

- **Protection of the product:**

Packaging helps to protect the product from heat, light, moisture, evaporation, dust etc. during its long passage from the factory to the target customers. It protects the products from breakage, leakage spoilage etc.

- **Transportation:**

Packaging facilitates transportation of products from one place to another. It ensures easy transportation and better handling of products in transit.

- **Guidelines to customers:**

Packaging helps as a guideline for the customers. From the informative literature regarding the quality and use of the product, the customers get the guidelines. The customers are ensured about the quality of the products.

- **Better storage:**

Packaging acts as a better storage of the products. Goods with good packages can be stored in the retail shop also in lesser price.

- **Facilitates for carrying:**

Packaging plays an important role in carrying the goods in transit and from one place to another. It is made in different sizes and it facilitates provisions for easy and open carrying.

- **Identification of product differentiation:**

Packaging helps to identify the product differentiation easily. It ensures the individuality of the products and one product can be easily differentiated with each other products in the market. The customers can easily identify their product of choice at the time of purchase. This helps the customers to prevent substitution of goods by other customers.

- **Economy:**

Packaging helps to reduce the cost of marketing the goods by reducing losses from damages. As packaging is helpful for sales promotion, so it helps to attain economy in the cost structure of the producers and marketers.

Types of packaging

There are various types of packaging some of them are as follow:

- **Consumer packaging:**



Consumer packaging is one which holds the required volume of a product for ultimate consumption. It is the means of buying household. In other words, the consumer has the option to purchase the pack size which he/she considers adequate for the consumption of his/her family over a length of time.

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- **Transit packaging:**

Transit packaging is another type of packaging. It is either for the industrial consumer's use. The consumer package itself very often requires an outside package in which it is sometimes referred to a bulk package or an outer container.

- **Industrial packaging:**

An industrial packaging can either describe a bulk package or the package for durable consumer goods. These are the basic package types although many subdivisions can be listed which can be broadly listed under these basic headings.

- **Dual use packaging:**

A dual packaging is one which has a secondary usefulness after its contents have been consumed. The examples of dual use packaging are Drinking glasses, boxes of jewelry, waste baskets, refrigerator dishes, etc.

Pricing Methods and Strategies

1. Pricing at a Premium

With [premium pricing](#), businesses set costs higher than their competitors. Premium pricing is often most effective in the early days of a product's life cycle, and ideal for small businesses that sell unique goods.

Because customers need to perceive products as being worth the higher price tag, a business must work hard to create a value perception. Along with creating a high-quality product, owners should ensure their marketing efforts, the product's packaging and the store's décor all combine to support the premium price.

2. Pricing for Market Penetration

[Penetration strategies](#) aim to attract buyers by offering lower prices on goods and services. While many new companies use this technique to draw attention away from their competition, penetration pricing does tend to result in an initial loss of income for the business.

Over time, however, the increase in awareness can drive profits and help small businesses to stand out from the crowd. In the long run, after sufficiently penetrating a market, companies often wind up raising their prices to better reflect the state of their position within the market.

3. Economy Pricing

Used by a wide range of businesses including generic food suppliers and discount retailers, economy pricing aims to attract the most price-conscious of consumers. With this strategy, businesses minimize the costs associated with marketing and production in order to keep product prices down. As a result, customers can purchase the products they need without frills.

While economy pricing is incredibly effective for large companies like Wal-Mart and Target, the technique can be dangerous for small businesses. Because small businesses lack the sales volume of larger companies, they may struggle to generate a sufficient profit when prices are too low. Still, selectively tailoring discounts to your most loyal customers can be a great way to guarantee their patronage for years to come.

4. Price Skimming

Designed to help businesses maximize sales on new products and services, [price skimming](#) involves setting rates high during the introductory phase. The company then lowers prices gradually as competitor goods appear on the market.

One of the benefits of price skimming is that it allows businesses to maximize profits on early adopters before dropping prices to attract more price-sensitive consumers. Not only does price skimming help a small business recoup its development costs, but it also creates an illusion of quality and exclusivity when your item is first introduced to the marketplace.

5. Psychology Pricing

With the economy still limping back to full health, price remains a major concern for American consumers. [Psychology pricing](#) refers to techniques that marketers use to encourage customers to respond on emotional levels rather than logical ones.

6. Bundle Pricing

With bundle pricing, small businesses sell multiple products for a lower rate than consumers would face if they purchased each item individually. Not only is bundling goods an effective way of moving unsold items that are taking up space in your facility, but it can also increase the value perception in the eyes of your customers, since you're essentially giving them something for free. Bundle pricing is more effective for companies that sell complimentary products. For example, a restaurant can take advantage of bundle pricing by including dessert with every entrée sold on a particular day of the week. Small businesses should keep in mind that the profits they earn on the higher-value items must make up for the losses they take on

the lower-value product. Pricing strategies are important, but it's also important to not lose sight of the price itself. Here are five things to consider, alongside your strategy, when pricing your products.

Promotion mix

1. Personal Selling

This is usually the most costly tool but is one of the most effective tools in the **promotional mix**. It is effective since it builds a long-term relationship between the client and employee that will continue coming back. This is of great benefit especially when dealing with clients that spend large amount of cash. The client could want a hotel for fifty people or he or she might be buying vehicles for each of his 30 businesses. Cultivating this relationship will increase the chances of future opportunities if his or her expectations are met.

However, this method does involve some risks. The client might decide that he or she does not need the services or products anymore thus causing the company to lose money. Companies invest heavily in this method take on greater risk since they depend on the cultivation of a relationship with a client that could falter eventually. Direct Marketing is comparable to personal selling.

2. Direct Marketing

Direct marketing uses technology to target clients individually. Examples include telephone calls, apps, e-mail, and catalogs. Direct marketing is useful since it targets individuals that spend small amounts of money at different times since they do not spend as much cash as frequently.

Different companies use e-mail to send out specials and deals to clients. Some companies such as Amazon use previous purchases to offer recommendations. Others just send out recommendations to everyone on their mailing list. Direct marketing is great especially when marketing to the masses but personalizing the message for every recipient.

3. Public relations

Every business needs public relations but many businesses often overlook it since they typically associate it with dealing with negative situations that can affect a company. A good Public Relations manager for a business should be dynamic to handle both positive and negative situations. On the positive side, a Public Relations campaign is implemented through newsletters, social media, press releases, grand openings, and major events. Social media is particularly a useful tool for public relations since the masses use it and love it. On the negative side, dealing with those negative situations is something that a public relations director should be in a position to handle effectively.

4. Sales Promotions

These provide a great way to get customers to buy a particular service or product.

Attraction factor

Sales promotions are particularly useful in the service industry since many people are not willing to pay full price for a vacation package. However, once they get a promotion of 20% off they become attracted to the offer immediately. Restaurants can also make use of sales promotions to boost sales by bringing more people into the restaurant. Sales promotions work for other industries too. You can find stores offering 20% discounts on selected items and so on.

Bundling

You will also find businesses bundling offers. For instance, you can find a restaurant offering two full meals, an appetizer, and dessert at a set price. The great thing about this is that the menu prices do not have to change because of the promotion. Similarly, you can find stores bundling together different items for the same price such as bread that comes with a slice of butter at the same price. This means that bundling is applicable across different industries.

5. Advertising

Advertising plays a key role when promoting a business. Newspapers, Radio, TV, and Social Media advertising all play an important role in determining how to target customers as well as how they will respond to the advertising message.

Social Media marketing

Social media is currently taking over from the traditional forms of advertising. Focus on social media is critical especially when communicating with clients. The reason for this is that Facebook is one of the most visited website globally on a daily basis. Furthermore, it is instantaneous. As soon as a company posts something on its Facebook page it immediately becomes available for all to see. In addition, Facebook offers the option of targeting users based on their interests, gender, location, age, and any other demographics that you can think of. In the 21 Century, Social Media marketing is simply the way to go.

Vertical Marketing Systems

A vertical marketing system (VMS) is one in which the main members of a distribution channel—producer, wholesaler, and retailer—work together as a unified group in order to meet consumer needs. In conventional marketing systems, producers, wholesalers, and retailers are separate businesses that are all trying to maximize their profits. When the effort of one channel member to maximize profits comes at the expense of other members, conflicts can arise that reduce profits for the entire channel. To address this problem, more and more companies are forming vertical marketing systems.

Vertical marketing systems can take several forms. In a corporate VMS, one member of the distribution channel owns the other members. Although they are owned jointly, each company in the chain continues to perform a separate task. In an administered VMS, one member of the channel is large and powerful enough to coordinate the activities of the other members without an ownership stake. Finally, a contractual VMS consists of independent firms joined together by contract for their mutual benefit. One type of contractual VMS is a retailer cooperative, in which a group of retailers buy from a jointly owned wholesaler. Another type of contractual VMS is a franchise organization, in which a producer licenses a wholesaler to distribute its products.

The concept behind vertical marketing systems is similar to vertical integration. In vertical integration, a company expands its operations by assuming the activities of the next link in the chain of distribution. For example, an auto parts supplier might practice forward integration by purchasing a retail outlet to sell its products. Similarly, the auto parts supplier might practice backward integration by purchasing a steel plant to obtain the raw materials needed to manufacture its products. Vertical marketing should not be confused with horizontal marketing, in which members at the same level in a channel of distribution band together in strategic alliances or joint ventures to exploit a new marketing opportunity.

Customer Relation Management

CRM or Customer Relationship Management is a strategy for managing an organisation's relationships and interactions with customers and potential customers. A CRM system helps companies stay connected to customers, streamline processes, and improve profitability.

When people talk about CRM, they are usually referring to a CRM system, a tool that is used for contact management, sales management, productivity, and more. The goal of a CRM system is simple: Improve business relationships.

CRM as Technology: This is a technology product, often in the cloud, that teams use to record, report and analyse interactions between the company and users. This is also called a [CRM system](#) or solution.

CRM as a Strategy: This is a business' philosophy about how relationships with customers and potential customers should be managed

CRM as a Process: Think of this as a the system a business adopts to nurture and manage those relationships.

CRM enables a business to deepen its relationships with customers, service users, colleagues, partners and suppliers.

Forging good relationships and keeping track of prospects and customers is crucial for customer acquisition and retention, which is at the heart of a CRM's function. You can see

everything in one place — a simple, customizable dashboard that can tell you a customer's previous history with you, the status of their orders, any outstanding customer service issues, and more.

Sales teams can use CRM to understand their sales pipeline better.

Sales managers can access reliable information about the progress of individual team members in achieving their sales targets, for example, and see how well individual sales teams, products and campaigns are performing too.

Sales reps benefit from reduced admin, a deeper understanding of their clients, and the opportunity to spend more time selling and less time inputting data.

Marketing teams can use CRM to make forecasting simpler and more accurate.

They can get clear visibility over every opportunity or lead, and map out the whole customer journey from enquiry through to sale, so giving them a better understanding of the sales pipeline or prospective work coming in.

It's also possible to include information from customers' public social media activity – their likes and dislikes, and their sentiment about specific brands and businesses.

Customer service teams can effectively track conversations across channels.

A customer might raise an issue in one channel – say, Twitter or Facebook – but then switch to email, phone or live chat to resolve it in private.

Without a common platform for customer interactions, communications can be missed or lost in the flood of information – leading to an unsatisfactory response to a valued customer.

Supply-chain, procurement and partner management teams can manage relationships better.

They can track meetings with suppliers and partners, record requests made, add useful notes, schedule follow-ups and stay on top of expected next steps.



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Reporting enables businesses to compare the efficiency of suppliers and so manage their entire supply chain more effectively.

The HR team can use CRM to accelerate the recruitment process and track employee performance.

CRM can help the HR function by speeding up the on-boarding process, automating the process of managing candidates, analysing resourcing needs and identifying skills gaps, and supporting the pursuit of staff retention targets.

Think about how convenient it would be to consolidate all the streams of data coming from sales teams, customer service staff, marketers and social media—and translate them into actionable business information. A CRM platform lets you manage these streams of information across channels without losing track, and gives sales, service, marketing, and beyond an integrated view.

The benefits and advantages of CRM include:

1. Enhanced contact management
2. Cross-team collaboration
3. Heightened productivity
4. Empowered sales management
5. Accurate sales forecasting
6. Reliable reporting
7. Improved sales metrics
8. Increased customer satisfaction and retention
9. Boosted marketing ROI
10. Enriched products and services

[The Internet as a Marketing Medium](#)

The Internet offers a startling set of advantages as a marketing medium. Technology advances, consumer familiarity and vendor innovation will inevitably drive both marketing

programs and customer interaction to center on the Internet. Marketers need to begin now an active exploration of their key initiatives in light of where and how to apply the Internet's power.

The Internet is already an important, and perhaps transformational, marketing medium for business-to-business and business-to-consumer markets. Executives and entrepreneurs must understand how and why this is so by answering these questions:

- How does the Web compare to traditional marketing vehicles?
- What relationship will emerge between the Web as marketing medium and traditional vehicles?
- How will advances in technology and increased usage affect the Internet's capability for marketing?



There are criteria that characterize the applicability and power of any marketing medium, whether we define marketing abstractly as the "conception, creation and sustenance" of customers, or more pragmatically as a "purposeful system of activities intended to promote the market exchange of goods or services."

REACH

The marketer's first task is to communicate key messages to the full set of targeted prospects, customers and influencers. As a medium, the Web has quickly achieved very broad reach, and will soon pass broadcast and cable television as the medium with the broadest consistent reach.

ABILITY TO TARGET

For optimal results, the marketer wants to be able to select the precise group with whom to communicate. Both the Web and the closely associated technology of e-mail will eventually provide extraordinary ability to target in both business-to-business and business-to-customer markets. Already the Internet provides more ability to target than many media, such as broadcast, cable or print; only direct mail, telemarketing and direct sales provide more.

Three likely changes could make the Internet the medium with the greatest ability to target. Societal norms for acceptable privacy policy will develop as consumers demonstrate by their actions which targeting information and techniques they see as "net positive." Databases of Internet users' demographic, psychographic, purchase, "anonymous profile" and other behavioral information will grow and be augmented with the enormous existing information available in the non-digital domain. Interactive profiling and mass customization technologies will mature from their currently raw state to deliver consumer experiences that will seem more personal than most other marketing media or sales contacts.

INTERACTIVITY

The ideal marketing medium allows the targeted prospects or customers to talk back right now - to identify themselves, to declare interest and readiness to purchase and even to criticize or complain. Internet and e-mail offer outstanding interactivity, comparable to direct sales at a fraction of the cost per contact. Today only telesales can compete. It is likely that increased ease of use and consumer familiarity will make the Internet the most interactive of marketing media.

AIDA COMPLETENESS

Marketing media have traditionally served only one or two steps of the Awareness-Interest-Desire-Action cycle (A.I.D.A.). For example, advertising can lead a consumer to action, but cannot generally consummate it. Many marketers believe that this inability to span the complete A.I.D.A. cycle is the major cause of "wasted" marketing effort. Consumers who have been motivated to continue in the purchase process are "lost" when they fail to navigate to the next step, which requires engagement in a new medium ("pick up your phone now and call").

The Internet offers unique power here. A customer can move easily from initial awareness through purchase. Only the beer vendor at the ballpark has as powerful an ability to raise awareness and execute the sale in one fluid motion!

Maintaining an accessible recollection of these interactions actually allows an exchange between the user and a Web site to continue for some time, spanning the time delays of the physical world. For example, the Amazon site has a better ability to pick up a "conversation" about a problem with the book ordered last week than do most humans working at a chain bookstore.

CONTRIBUTION TO LEARNING

Ideally, the marketing process should function as a learning system. Database marketers, for example, have made a science of the "closed loop," in which programs are conceived and executed against a database that has been segmented using analytical profiling and predictive applications. The database and even the applications are then updated to reflect the actual performance of the particular marketing program.

Today, only the expensive direct marketing methods - direct mail, telesales and direct sales - can serve easily as a foundation for quantitative marketing learning. Measuring traditional advertising and public relations, for example, relies on subjective assessment and sampling techniques such as Nielsen ratings, which are both expensive and of doubtful usefulness in the smaller segments that characterize so many markets.

In contrast, the Internet already enables unprecedented learning in its ability to capture site navigation information; information retrieval and purchase behavior, and user-supplied preference and profiling information. It is also proving to be an excellent vehicle for conventional market and customer research.

IMMEDIACY AND RELEVANCY

Responsiveness to marketing messages is closely correlated with the "freshness" and applicability of the information conveyed to the recipient. While direct sales and telesales offer the ability to present a timely message, the Internet is vastly superior to all other media in the capacity to deliver messages that are not only timely, but immediately relevant to the recently displayed interests or actions of the customer.

PERMISSION

Seth Godin, founder of Yoyodyne and author of marketing books, argues persuasively that the volume of marketing information aimed at customers has necessitated that we no longer market "to" the customer; instead, we need to market "with" the customer. Practically, this means seeking the customer's permission to begin and then continue a dialogue that will extend beyond one sales transaction.

While direct sales and telesales provide these options, the Internet enables the "permission" decision to be made at lower cost to the vendor and with less inconvenience to the customer.

MULTIPLE PROGRAM TYPES

The Internet has a unique ability to function as a platform or vehicle for a variety of program types. Using the Web and e-mail, we can run awareness advertising, send targeted mail, fulfill collateral requests, conduct a seminar, drive a public relations campaign and offer a premium for an immediate action.

DELIVER APPROPRIATE INFORMATION

The Internet has another unique ability: to provide virtually unlimited information to the seriously interested user, without cluttering simpler messages to a wider audience. The end user can easily navigate his or her way to more and more detailed information and toward a closer relationship with the supplier. It is as though an advertiser could enable a print reader to touch the page of a wordless "branding" ad and instantly receive a mail packet of the appropriate product brochures, specifications, competitive comparisons and local dealer contact.

But the Internet has weak points as well that must be considered.

PRODUCTION IMPACT CAPACITY

It sometimes takes sizzle to engage a sated consumer, and that can mean high-quality graphics, motion and sound. The weaknesses of the personal computer as a multimedia

vehicle, combined with inadequate access bandwidth, mean that the production values achievable in Web marketing lag other media significantly. While broadband access, PC improvements, and Internet appliances will inevitably address this issue, it will be at least three years before a mass market emerges that can experience TV- or magazine-quality communications over the Web with reasonable performance.

CUSTOMER ATTENTIVENESS

While an Internet "opt-in" session can be wonderfully compelling for vendor and customer alike, Internet broadcast vehicles - principally conventional banner ads - are far weaker than broadcast advertising in commanding the prospect's attention. It is more difficult to tune out a well- executed TV or radio spot than to ignore a good banner ad.

CONTROL OF USER EXPERIENCE

While the Internet offers great capability for the marketer to be responsive during a customer interaction, it also puts new control of the experience into the hands of the customer.

Traditionally, marketing operated under the assumption that the prospect could be led through a progressive process of information disclosure and purchase commitment. On the Web, this illusion is destroyed - the customer is in control. He or she can dig deeper, or leap to a competitor's site, in a single click.

Thus, we must design our marketing communications for access under customer control. More importantly, a new urgency is created - at every moment, the prospect is free to abandon the process. For example, the inconvenience associated with walking out of a store at the moment of purchase, "upsetting" the sales clerk, is completely absent.

MARKETING FUTURE

Clearly, the strengths of the Internet as a marketing medium far outweigh the negatives. Companies grappling with the issue of whether to market via the Internet are already behind. Companies attempting to build a coherent Internet marketing strategy must begin to believe

that the Web is likely to be the center of their marketing future, not simply an adjunct to traditional marketing methods.

New issues in Marketing

High Volatility in Market

1. Volatile Market: – It is a market with great deal of price instability.
– Highly risky.
2. Before 2008: higher demand for products and services.
3. After 2008: demand declined due to volatility.
4. The definition of long and short term market has undergone a change.

Ultimate challenges :Manage inventories in the distribution channels in short term, more complex and difficult marketing planning and more difficulty in market forecasting.

Diversity and Convergence

- Indian market: highly diverse due to the demography of Indian population.
- Diversity: young and old, tech and non-tech savvy, regional disparities, religion.
- Convergence among different markets.
- Example: value of convenience, clarity of voice and no call drop- all seek in a cell phone connection. Price and services of handset and services change according to the segment.
- Depth of the product mix is shown by large retail stores.
- Marketer makes his offer available with multiple price options- gives the customer, choice.

Catering to the affluent

- Growing segment of affluent customers.
- Hindustan Times organised the first ever conference on luxury– attended by Cartier, Jimmy Choo, Gucci, Villa Moda, Taj Hotels...

- Luxury goes beyond materialistic aspect – aspirational, emotional and experiential platform has to be created.
- Marketer has to continuously innovate on product design and upgrade.

Poor markets also need marketing

- Poor customer exists in both rural and urban areas.
- Poor may be: “All those who spend up to US \$ 1 on the basis of PPP “(purchasing power parity) – per person per day on consumption expenditure.
- 35% of Indian population fell in the group.
- Challenges: Adapting marketing programme to this segment, innovation for this market, create means for consumption and funding for this consumption is arranged through self help groups and micro finance in this segment.

Engaging customer 24×7

- Average attention of customer has decreased over years. Reason- competition.
- The noise in the media and distribution outlets is loud.
- Through television, radio channels, outdoor advertising and print media.
- Fundamentals to customer acquisition and retention:
Creativity, respecting customer’s right to privacy.
Creating an emotional experience.

Consumer communities

- Growing trend of consumers coming together to form communities.
- Offer significant inputs in consumer psychology and consumption behaviour.
- Internet has facilitated this growth.
- Blogs, web, chat rooms- most commonly used tools for creation of these communities.
- Consumers come together to share their experiences about the products and brands + discuss their personal and professional life.

- Eg:
Gang of Girls – gangofgirls.com – It is promoted by Sunilk.
www.pagalguy.com – It is an MBA students and aspirants website where any student/aspirant can post their entry.
- Social networking sites- facebook.com, myspace.com- users present a structured profile of the self to the world.
– The information from these sites are used by the marketers for customising the marketing mix.
- Causes:
Save Mumbai, Jessica Lal case are examples of social causes.
Pepsi and Coke- ecological issues in case of impurities.

Enhancing access

- Access to products and services restricted due to:
Infrastructure constraints
2. Lack of distribution network.
- Access enabled through:
Improvement in information and communication technology.
Outsourcing
Direct Marketing
Network Marketing

Price and value major determinants in consumption behaviour

- Value in the offer, far important than price in then consumer decision.
- Better service and lower price always attracts the consumer.
- Value of service depends on convenient location of the store, ready availability of the product, immediate installation and commissioning.
- Marketer has to continuously examine how to create value and retain competitive advantage.

New icons

- In order to manage their credibility on an ongoing basis.
- Past earned laurels do not stop the brands from working on their image.
- Any adverse news about them in the media can have an impact on their image.
- New icons need not be celebrities.
- Need to be credible.
- An Indian idol today is young with a carefree attitude, assertive, confident, adventurous, and unconventional and a highly performance-centric individual.

Indian global brands

- Arcelor Mittal (L.N. Mittal group), Tata Corus, Infosys, Bharat Forage, Ranbaxy, Wipro Barista, Taj, Haldiram, Kitchens Of India, IITs, IIMs – globally recognised Indian brands.
- Still they have a long way to go to be Coca Cola or Microsoft.
- In their movement, they are redefining the marketing rules in their product category in foreign markets.
- Challenge is to make the Indian global brands stonger.



Ecology sensitivity

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- It meant all about ‘Going green’.
- Delhi’s public transport
- Samsung refrigerators marketed has environmentally safe.
- Hotels like Leela, Orchid and Taj claim that they provide services which are environmentally safe.
- Implications for product design and communication.

Word of mouth

- Social channels help in product diffusion and adoption.
- Biotique products are the best examples for product which sell significantly through word of mouth.

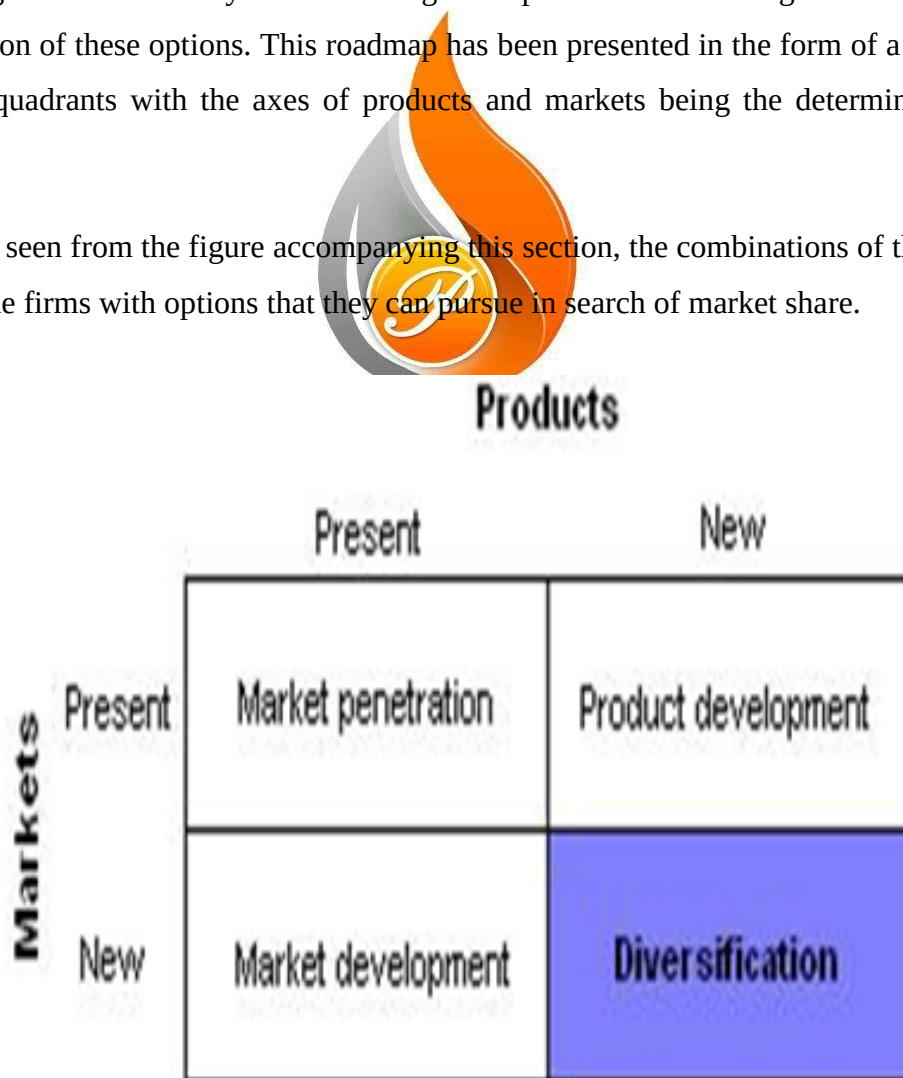
- The product is placed in the customer's hands through presentations in five star hotel guest rooms – this is frequented by the opinion leaders and affluent customers.
- Best known websites in the target market segments: buyandselloldbooks.com, mouthshut.com
- Challenge was to identify the right opinion leaders and get them to try the product.

STRATEGIC MARKETING CONCEPTS

ANSOFF MATRIX

The famous management expert, Igor Ansoff provided a roadmap for firms to grow depending on whether they are launching new products or entering new markets or a combination of these options. This roadmap has been presented in the form of a Matrix that has four quadrants with the axes of products and markets being the determinants of the strategies.

As can be seen from the figure accompanying this section, the combinations of the two axes provide the firms with options that they can pursue in search of market share.



Ansoff Matrix

The four quadrants (which are described in detail subsequently) pertain to increasing market share through market penetration, venturing into new markets with the existing products or market development, and launching new products in existing markets with product development, and finally, diversification when firms seek to enter new markets with new products.

Market Penetration

As can be seen from the figure above, market penetration happens when the existing products are marketed in a way to increase the market share of the firm. This is a minimal risk strategy as all that a firm has to do is to increase its marketing efforts and improve on its market share. In other words, the firm has to ensure that it leverages the current capabilities, resources, and gears towards a growth-oriented strategy. However, market penetration has its limitations and these manifest when the market is saturated and hence, growth diminishes for the products. Examples of market penetration would include the Television Channels and Media Houses trying to maintain their existing features in the existing markets and ensuring that they grow because of the growth in the size of the market or because they have provided a value proposition that is better than their competitors are.



Market Development

When firms seek to expand into new markets with their existing products, market development happens. This is suitable for firms that have the capabilities and the resources to enter new markets in pursuit of growth. Further, the firm's core competencies must be aligned with the products rather than the markets and wherein the firm senses an opportunity in the new markets for its existing products. Market development is more risky than market penetration as the firm is entering uncharted waters and therefore, it is in the interests of the firms to do their due diligence before entering new markets. Examples of market development would be the mobile telephony companies like Vodafone and Nokia entering African markets where these markets are yet to be tapped and where these firms can leverage their existing expertise to enter these markets.

Product Development

When firms seek to launch new products in existing markets, product development happens. This strategy can be successful when the firms have already established themselves in the existing markets and all that they need to do is to launch new products, which leverage the brand image and the brand value and meet the expectations of the customers in the existing markets. For instance, whenever consumer giants like Unilever and Procter and Gamble (P&G) launch new products in existing markets, they have the advantage of a strong brand value and top of the mind recall among the customers about them, which would help them to garner market share. When compared to the previous two strategies, this strategy is more risky as it is not sure whether the transfer of customers from the existing products to the new products would happen as seamlessly as the firms strategists believe.

Diversification

When firms launch new products in new markets, diversification happens which entails both new products to be developed and new markets to be tapped. This is the most risky of the four quadrant strategies in the Ansoff Matrix as essentially the firms are not only testing the waters in uncharted territory but they are also launching new products that may or may not be well received by the customers. Indeed, diversification is a high-risk strategy and is only justified when there are chances of high returns for the firms. Examples of diversification would include companies like Reliance venturing into mobile telephony and retail segments where they not only have to move away from their core competencies but also have to launch new products targeted at the new customer segment. Management experts recommend diversification only when the firms are sitting on enough cash and other resources, as the firms need to have deep pockets to stay the course until the time profits are realized. Further, they also recommend firms with existing customer loyalty and customer base as the cross migration from one segment to the other happens only when the customers are assured of receiving value for their money. For instance, the TATA group in India is perceived as delivering good value and this helped them to garner market share when they diversified into new markets and new products.

Conclusion

As can be seen from the preceding discussion, it is imperative for firms to grow as otherwise their resources would not generate the returns needed for the firms to make profits as well as deliver value to their shareholders. Moreover, firms need to continually look for ways and means to increase their market share, which would help them create value for their stakeholders. This is the reason why the Ansoff Matrix has become so popular because it charts the strategies that the firms must follow in each option, which again is a combination of the firms' current capabilities, and the possibility of new market led growth. In conclusion, the Ansoff Matrix is very relevant in these recessionary times as it can be applied by any firm wishing to either expand into newer markets or leverage its existing capabilities.

BCG Matrix

Boston Consulting Group (BCG) Matrix is a four celled matrix (a 2 * 2 matrix) developed by BCG, USA. It is the most renowned corporate portfolio analysis tool. It provides a graphic representation for an organization to examine different businesses in it's portfolio on the basis of their related market share and industry growth rates. It is a two dimensional analysis on management of SBU's (Strategic Business Units). In other words, it is a comparative analysis of business potential and the evaluation of environment.

According to this matrix, business could be classified as high or low according to their industry growth rate and relative market share.

Relative Market Share = $\frac{\text{SBU Sales this year}}{\text{leading competitors sales this year}}$

Market Growth Rate = $\frac{\text{Industry sales this year} - \text{Industry Sales last year}}{\text{Industry Sales last year}}$

The analysis requires that both measures be calculated for each SBU. The dimension of business strength, relative market share, will measure comparative advantage indicated by market dominance. The key theory underlying this is existence of an experience curve and that market share is achieved due to overall cost leadership.

BCG matrix has four cells, with the horizontal axis representing relative market share and the vertical axis denoting market growth rate. The mid-point of relative market share is set at 1.0. if all the SBU's are in same industry, the average growth rate of the industry is used. While, if all the SBU's are located in different industries, then the mid-point is set at the growth rate for the economy.

Resources are allocated to the business units according to their situation on the grid. The four cells of this matrix have been called as stars, cash cows, question marks and dogs. Each of these cells represents a particular type of business.

BCG Matrix

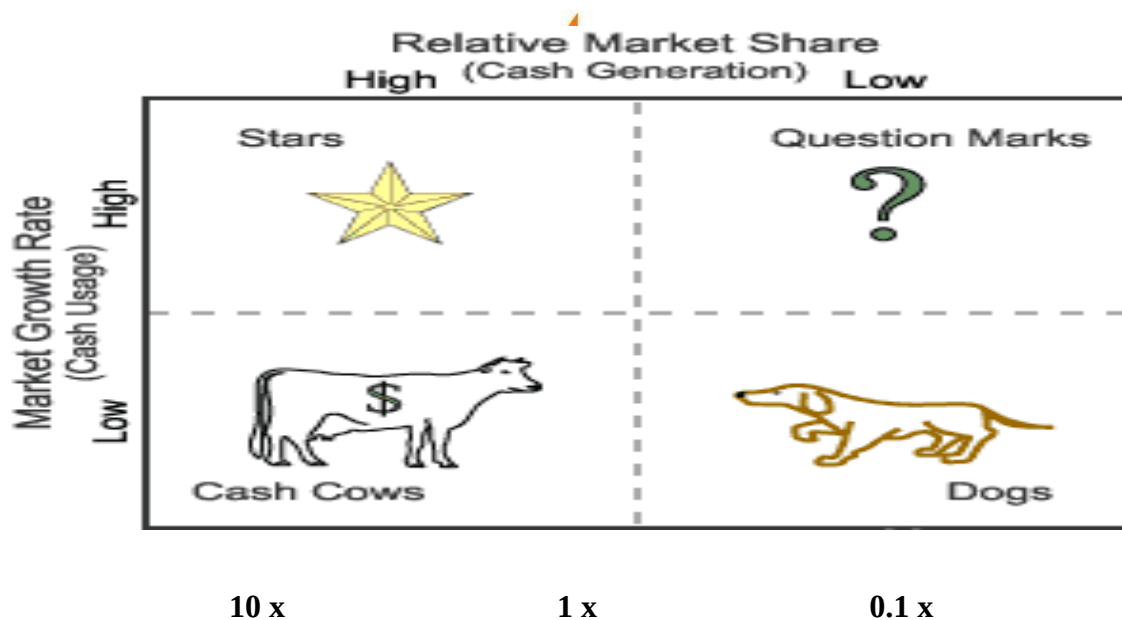


Figure: BCG Matrix

Stars- Stars represent business units having large market share in a fast growing industry. They may generate cash but because of fast growing market, stars require huge investments to maintain their lead. Net cash flow is usually modest. SBU's located in this cell are attractive as they are located in a robust industry and these business units are highly competitive in the industry. If successful, a star will become a cash cow when the industry matures.

Cash Cows- Cash Cows represents business units having a large market share in a mature, slow growing industry. Cash cows require little investment and generate cash that can be utilized for investment in other business units. These SBU's are the corporation's key source of cash, and are specifically the core business. They are the base of an organization. These businesses usually follow stability strategies. When cash cows lose their appeal and move towards deterioration, then a retrenchment policy may be pursued.

Question Marks- Question marks represent business units having low relative market share and located in a high growth industry. They require huge amount of cash to maintain or gain market share. They require attention to determine if the venture can be viable. Question marks are generally new goods and services which have a good commercial prospective. There is no specific strategy which can be adopted. If the firm thinks it has dominant market share, then it can adopt expansion strategy, else retrenchment strategy can be adopted. Most businesses start as question marks as the company tries to enter a high growth market in which there is already a market-share. If ignored, then question marks may become dogs, while if huge investment is made, then they have potential of becoming stars.

Dogs- Dogs represent businesses having weak market shares in low-growth markets. They neither generate cash nor require huge amount of cash. Due to low market share, these business units face cost disadvantages. Generally retrenchment strategies are adopted because these firms can gain market share only at the expense of competitor's/rival firms. These business firms have weak market share because of high costs, poor quality, ineffective marketing, etc. Unless a dog has some other strategic aim, it should be liquidated if there is fewer prospects for it to gain market share. Number of dogs should be avoided and minimized in an organization.

Limitations of BCG Matrix

The BCG Matrix produces a framework for allocating resources among different business units and makes it possible to compare many business units at a glance. But BCG Matrix is not free from limitations, such as-

1. BCG matrix classifies businesses as low and high, but generally businesses can be medium also. Thus, the true nature of business may not be reflected.
2. Market is not clearly defined in this model.
3. High market share does not always leads to high profits. There are high costs also involved with high market share.
4. Growth rate and relative market share are not the only indicators of profitability. This model ignores and overlooks other indicators of profitability.
5. At times, dogs may help other businesses in gaining competitive advantage. They can earn even more than cash cows sometimes.
6. This four-celled approach is considered as to be too simplistic.

PORTER'S FIVE FORCES MODEL OF COMPETITION

Michael Porter (Harvard Business School Management Researcher) designed various vital frameworks for developing an organization's strategy. One of the most renowned among managers making strategic decisions is the five competitive forces model that determines industry structure. According to Porter, the nature of competition in any industry is personified in the following five forces:

1. Threat of new potential entrants
2. Threat of substitute product/services
3. Bargaining power of suppliers
4. Bargaining power of buyers
5. Rivalry among current competitors



Porters Five Forces Model of Competition

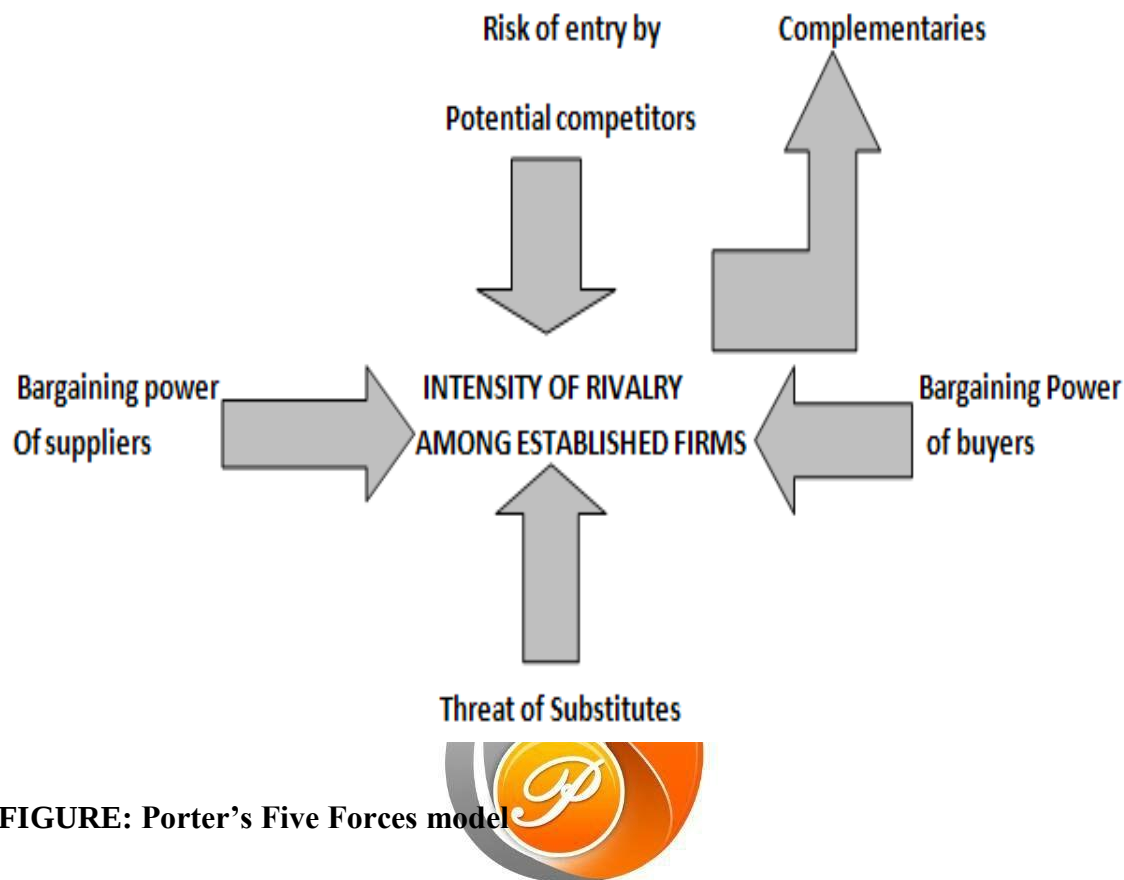


FIGURE: Porter's Five Forces model

The five forces mentioned above are very significant from point of view of strategy formulation. The potential of these forces differs from industry to industry. These forces jointly determine the profitability of industry because they shape the prices which can be charged, the costs which can be borne, and the investment required to compete in the industry. Before making strategic decisions, the managers should use the five forces framework to determine the competitive structure of industry.

Let's discuss the five factors of Porter's model in detail:

Risk of entry by potential competitors: Potential competitors refer to the firms which are not currently competing in the industry but have the potential to do so if given a choice. Entry of new players increases the industry capacity, begins a competition for market share and lowers the current costs. The threat of entry by potential competitors is partially a function of extent of barriers to entry. The various barriers to entry are-

Economies of scale

Brand loyalty

Government Regulation

Customer Switching Costs

Absolute Cost Advantage

Ease in distribution

Strong Capital base

Rivalry among current competitors: Rivalry refers to the competitive struggle for market share between firms in an industry. Extreme rivalry among established firms poses a strong threat to profitability. The strength of rivalry among established firms within an industry is a function of following factors:

Extent of exit barriers

Amount of fixed cost

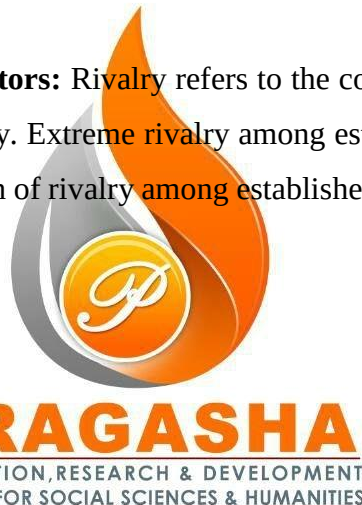
Competitive structure of industry

Presence of global customers

Absence of switching costs

Growth Rate of industry

Demand conditions



Bargaining Power of Buyers: Buyers refer to the customers who finally consume the product or the firms who distribute the industry's product to the final consumers. Bargaining power of buyers refer to the potential of buyers to bargain down the prices charged by the

firms in the industry or to increase the firms cost in the industry by demanding better quality and service of product. Strong buyers can extract profits out of an industry by lowering the prices and increasing the costs. They purchase in large quantities. They have full information about the product and the market. They emphasize upon quality products. They pose credible threat of backward integration. In this way, they are regarded as a threat.

Bargaining Power of Suppliers: Suppliers refer to the firms that provide inputs to the industry. Bargaining power of the suppliers refer to the potential of the suppliers to increase the prices of inputs(labour, raw materials, services, etc) or the costs of industry in other ways. Strong suppliers can extract profits out of an industry by increasing costs of firms in the industry. Suppliers products have a few substitutes. Strong suppliers' products are unique. They have high switching cost. Their product is an important input to buyer's product. They pose credible threat of forward integration. Buyers are not significant to strong suppliers. In this way, they are regarded as a threat.

Threat of Substitute products: Substitute products refer to the products having ability of satisfying customers needs effectively. Substitutes pose a ceiling (upper limit) on the potential returns of an industry by putting a setting a limit on the price that firms can charge for their product in an industry. Lesser the number of close substitutes a product has, greater is the opportunity for the firms in industry to raise their product prices and earn greater profits (other things being equal).

The power of Porter's five forces varies from industry to industry. Whatever be the industry, these five forces influence the profitability as they affect the prices, the costs, and the capital investment essential for survival and competition in industry. This five forces model also help in making strategic decisions as it is used by the managers to determine industry's competitive structure.

Porter ignored, however, a sixth significant factor- complementaries. This term refers to the reliance that develops between the companies whose products work is in combination with each other. Strong complementors might have a strong positive effect on the industry. Also,

the five forces model overlooks the role of innovation as well as the significance of individual firm differences. It presents a stagnant view of competition.

COMPETITOR ANALYSIS - MEANING, OBJECTIVES AND SIGNIFICANCE

Organizations must operate within a competitive industry environment. They do not exist in vacuum. Analyzing organization's competitors helps an organization to discover its weaknesses, to identify opportunities for and threats to the organization from the industrial environment. While formulating an organization's strategy, managers must consider the strategies of organization's competitors. Competitor analysis is a driver of an organization's strategy and effects on how firms act or react in their sectors. The organization does a competitor analysis to measure / assess its standing amongst the competitors.

Competitor analysis begins with identifying present as well as potential competitors. It portrays an essential appendage to conduct an industry analysis. An industry analysis gives information regarding probable sources of competition (including all the possible strategic actions and reactions and effects on profitability for all the organizations competing in the industry). However, a well-thought competitor analysis permits an organization to concentrate on those organizations with which it will be in direct competition, and it is especially important when an organization faces a few potential competitors.

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Michael Porter in Porter's Five Forces Model has assumed that the competitive environment within an industry depends on five forces- Threat of new potential entrants, Threat of substitute product/services, bargaining power of suppliers, bargaining power of buyers, Rivalry among current competitors. These five forces should be used as a conceptual background for identifying an organization's competitive strengths and weaknesses and threats to and opportunities for the organization from its competitive environment.

The main objectives of doing competitor analysis can be summarized as follows:

- To study the market;
- To predict and forecast organization's demand and supply;
- To formulate strategy;

- To increase the market share;
- To study the market trend and pattern;
- To develop strategy for organizational growth;
- When the organization is planning for the diversification and expansion plan;
- To study forthcoming trends in the industry;
- Understanding the current strategy strengths and weaknesses of a competitor can suggest opportunities and threats that will merit a response;
- Insight into future competitor strategies may help in predicting upcoming threats and opportunities.

Competitors should be analyzed along various dimensions such as their size, growth and profitability, reputation, objectives, culture, cost structure, strengths and weaknesses, business strategies, exit barriers, etc.

STRATEGIC GROUP MAPPING

Strategic group mapping one of a useful and innovative technique used to rectify and evaluate the rival's firm position in an industry. In today's market, every industry consists of rivals who enjoy benefits as compare to other companies. Thus, it is an important issue to rectify as well as to evaluate the major factors on the basis of which companies enjoys benefits and gain certain edge over other companies. Strategic group mapping is known as an important area with the help of which rival's activities are easily identified. Below mentioned are some of the main issues related to strategic group mapping:

1. Helps in identifying barriers for entry and exit
2. Helps in identifying strategic areas with the help of which benefits can be easily gained
3. Helps in identifying best firms in the industry
4. Helps in rectifying major rivals

Strategic group mapping is an important area with the help of which firms can easily analyze where they actually need betterments and with the help of this firms do well and gain well. Constructing strategic group map is a challenging task in which firms requires a clear and vivid analysis in order to gain effective outcomes. Below mentioned are some major steps required in constructing strategic group map:

1. Try to analyze and evaluate the rival's major areas
2. Setting major areas properly. For instance price and geographic coverage etc
3. Same firms should be allocated properly
4. In the end, follow every step strategically

Strategic group mapping can helps any firm to make its position strong enough in an industry. This is the best way with the help of which a firm can stay back for a long time and can enjoy numerous benefits. With the help of this strategy, firms easily identify about their rivals and then work accordingly in order to gain potential advantages and to be the one who can achieve high benefits



Unit - 7: Financial Management

- ✓ Capital Structure, Financial and Operating Leverage
- ✓ Cost of Capital, Capital Budgeting
- ✓ Working Capital Management
- ✓ Dividend Policy

MEANING, DEFINITION AND NATURE OF FINANCIAL MANAGEMENT:

Financial management is that managerial activity which is concerned with the planning and controlling of the firm's financial resources. In other words it is concerned with acquiring, financing and managing assets to accomplish the overall goal of a business enterprise (mainly to maximise the shareholder's wealth).

“Financial management is concerned with the efficient use of an important economic resource, namely capital funds” - Solomon Ezra & J. John Pringle.

“Financial management is the operational activity of a business that is responsible for obtaining and effectively utilizing the funds necessary for efficient business operations”- J.L. Massie.



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The management of the finances of a business / organisation in order to achieve financial objectives

Taking a commercial business as the most common organisational structure, the key objectives of financial management would be to:

- Create wealth for the business
- Generate cash, and
- Provide an adequate return on investment - bearing in mind the risks that the business is taking and the resources invested.

There are three key elements to the process of financial management:

(1) Financial Planning

Management need to ensure that enough funding is available at the right time to meet the needs of the business. In the short term, funding may be needed to invest in equipment and stocks, pay employees etc.

In the medium and long term, funding may be required for significant additions to the productive capacity of the business or to make acquisitions.

(2) Financial Control

Financial control is a critically important activity to help the business ensure that the business is meeting its objectives. Financial control addresses questions such as:

- Are assets being used efficiently?
- Are the businesses assets secure?
- Do management act in the best interest of shareholders and in accordance with business rules?

(3) Financial Decision-making

The key aspects of financial decision-making relate to investment, financing and dividends:

- Investments must be financed in some way – such as selling new shares, borrowing from banks or taking credit from suppliers etc.
- A key financing decision is whether profits earned by the business should be retained rather than distributed to shareholders via dividends. If dividends are too high, the business may be starved of funding to reinvest in growing revenues and profits further.

Nature of Financial Management

- It is an indispensable organ of business management.
- Its function is different from accounting function.
- It is a centralised function.



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- Helpful in decisions of top management.
- It applicable to all types of concerns.
- It needs financial planning, control and follow-up.

It related with different disciplines like economics, accounting, law, information technology, mathematics etc.

SCOPE AND FUNCTIONS OF FINANCIAL MANAGEMENT:

The scope of financial management has undergone changes over the years . Until the middle of this century, its scope was limited to procurement of funds. In the modern times ,the financial management includes besides procurement of funds ,the three different kinds of decision as well namely investment, financing and dividend .Scope and importance of financial management includes-

- 
- ☐ Estimating the total requirements of funds for a given period.
 - ☐ Raising funds through various sources, both national and international, keeping in mind the cost effectiveness;
 - ☐ Investing the funds in both long term as well as short term capital needs;
 - ☐ Funding day-to-day working capital requirements of business;
 - ☐ Collecting on time from debtors and paying to creditors on time;
 - ☐ Managing funds and treasury operations;
 - ☐ Ensuring a satisfactory return to all the stake holders;
 - ☐ Paying interest on borrowings;
 - ☐ Repaying lenders on due dates;
 - ☐ Maximizing the wealth of the shareholders over the long term;
 - ☐ Interfacing with the capital markets;
 - ☐ Awareness to all the latest developments in the financial markets;
 - ☐ Increasing the firm's competitive financial strength in the market; and
 - ☐ Adhering to the requirements of corporate governance.

The above scope of activities can be grouped in to three functions-

FUNCTIONS OF FINANCIAL MANAGEMENT:

The modern approach to the financial management is concerned with the solution of major problems like investment financing and dividend decisions of the financial operations of a business enterprise. Thus, the functions of financial management can be broadly classified into three major decisions, namely:

- (a) *Investment decisions,*
- (b) *Financing decisions,*
- (c) *Dividend decisions.*

1. Investment decisions: These decisions relate to the selection of assets in which funds will be invested by a firm .Funds procured from different sources have to be invested in various kinds of assets . Long term funds are used in a project for various fixed assets and also for current assets. The investment of funds in a project has to be made after careful assessment of the various projects through capital budgeting .A part of long term fund is also to be kept for financing the working capital requirements.

2. Financing decision : These decisions relate to acquiring the optimum finance to meet financial objectives and seeing that fixed and working capital are effectively managed. It includes sources of available funds and their respective cost, capital structure,i.e. a proper balance between equity and debt capital. It segregate profit and cash flow, financing decisions also call for a good knowledge of evaluation of risk.

3. Dividend decision- These decisions relate to the determination as to how much and how frequently cash can be paid out of the profits of an organisation as income for its owners/shareholders, and the amount to be retained to support the growth of the organisation .The level and regular growth of dividends represent a significant factor in determining a profit making company's market value i.e. the value placed on its shares by the stock market.

All the above three type of decisions are interrelated ,the first two pertaining to any kind of organisation while the third relates only to profit making organisations, thus it can be seen

that financial management is of vital importance at every level of business activity ,from a sole trader to the largest multinational corporation.

FUNCTIONAL AREAS OF FINANCIAL MANAGEMENT

- ☐ Capital Budgeting
- ☐ Working Capital Management
- ☐ Dividend Policies
- ☐ Acquisitions and Mergers
- ☐ Corporate Taxation
- ☐ Determining Financial Needs
- ☐ Determining Sources of Funds
- ☐ Financial Analysis
- ☐ Optimal Capital Structure
- ☐ Cost Volume Profit Analysis
- ☐ Profit Planning and Control
- ☐ Fixed Assets Management
- ☐ Project Planning and Evaluation.



OBJECTIVE OF FINANCIAL MANAGEMENT :

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Financial Management as the name suggests is management of finance. It deals with planning and mobilization of funds required by the firm. Managing of finance is nothing but managing of money. Every activity of an organization is reflected in its financial statements. Financial Management deals with activities which have financial implications. Efficient financial management requires the existence of some objectives or goals because judgment as to whether or not a financial decision is efficient must be made in the light of some objectives. It includes-

- ☐ Profit maximisation and wealth /value maximisation
- ☐ Achieving a higher growth rate.
- ☐ Attaining a large market share.
- ☐ Promoting employee welfare

- ☐ Increasing customer satisfaction.
- ☐ Improve community life.

Among these, a conflict included in profit maximisation and wealth /value maximisation objective i.e.-

The primary objective of a business is to earn profit; hence the objective of financial management is also profit maximisation. If profit is given undue importance, a number of problems can arise, such as-

- ☐ It does not take into account the time pattern of returns.
- ☐ It fails to take into account the social consideration to workers, customers etc.
- ☐ The term profit is vague – it conveys a different meaning to different people .e.g. total profit, rate of profit etc.

In wealth maximisation business firm maximise its market value ,it implies that business decision should seek to increase the net present value of the economic profit of the firm .It is the duty of the finance manager to see that the share holders get good return on the share (EPS - Earning per Share). Hence, the value of the share should increase in the stock market.

The wealth maximisation objective is generally in accord with the interest of the various groups such as owners, employees etc.

Owing to limitation (timing, social consideration etc.) in profit maximisation, in today's real world situations which is uncertain and multi-period in nature, wealth maximisation is a better objective .Where the time period is short and degree of uncertainty is not great, wealth maximisation and profit maximisation amount to essentially the same.

TIME VALUE OF MONEY AND MATHEMATICS OF FINANCE

Concept

We know that ₹ 100 in hand today is more valuable than ₹ 100 receivable after a year.

We will not part with ₹ 100 now if the same sum is repaid after a year. But we might part with 100 now if we are assured that ₹ 110 will be paid at the end of the first year. This “additional Compensation” required for parting ₹ 100 today, is called “interest” or “the time value of money”. It is expressed in terms of percentage per annum.

Money should have time value for the following reasons:

- ☐ Money can be employed productively to generate real returns;
- ☐ In an inflationary period, a rupee today has higher purchasing power than a rupee in the future;
- ☐ Due to uncertainties in the future, current consumption is preferred to future Consumption.
- ☐ The three determinants combined together can be expressed to determine the rate of interest as follows :

Nominal or market interest rate

= Real rate of interest or return (+) Expected rate of inflation (+) Risk premiums to compensate for uncertainty.



Time Value of Money and mathematics

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- (1) Compounding: We find the Future Values (FV) of all the cash flows at the end of the time period at a given rate of interest.
- (2) Discounting: We determine the Time Value of Money at Time “O” by comparing the initial outflow with the sum of the Present Values (PV) of the future inflows at a given rate of interest.

Time Value of Money

Compounding

(Future Value)

(a) Single Flow

(b) Multiple Flows

(c) Annuity

Discounting

(Present Value)

(a) Single Flow

(b) Uneven Multiple Flows

(c) Annuity

Future Value of a Single Flow

It is the process to determine the future value of a lump sum amount invested at one point of time.

$$FV_n = PV (1+i)^n$$

Where,

FV_n = Future value of initial cash outflow after n years

PV = Initial cash outflow

i = Rate of Interest p.a.

n = Life of the Investment and $(1+i)^n$ = Future Value of Interest Factor (FVIF)

Present Value of a Single Flow :

$$PV = \frac{FV_n}{(1+i)^n}$$



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Where, PV = Present Value

FV_n = Future Value receivable after n years

i = rate of interest

n = time period

CONCEPT OF RISK AND RETURN

Return expresses the amount which an investor actually earned on an investment during a certain period. Return includes the interest, dividend and capital gains; while risk represents the uncertainty associated with a particular task. In financial terms, risk is the chance or probability that a certain investment may or may not deliver the actual/expected returns.

Investors make investment with the objective of earning some tangible benefit. This benefit in financial terminology is termed as return and is a reward for taking a specified amount of risk.

Risk is defined as the possibility of the actual return being different from the expected return on an investment over the period of investment. Low risk leads to low returns. For instance, in case of government securities, while the rate of return is low, the risk of defaulting is also low. High risks lead to higher potential returns, but may also lead to higher losses. Long-term returns on stocks are much higher than the returns on Government securities, but the risk of losing money is also higher.

The risk and return trade off says that the potential return rises with an increase in risk. It is important for an investor to decide on a balance between the desire for the lowest possible risk and highest possible return. Rate of return on an investment can be calculated using the following formula- $\text{Return} = (\text{Amount received} - \text{Amount invested}) / \text{Amount invested}$.

The functions of Financial Management involves acquiring funds for meeting short term and long term requirements of the firm, deployment of funds, control over the use of funds and to trade-off between risk and return.

INVESTMENT DECISION

Investment decision relates to the determination of total amount of assets to be held in the firm, the composition of these assets and the business risk complexions of the firm as perceived by its investors. It is the most important financial decision that the firm makes in pursuit of making shareholders wealth.

Investment decision can be classified under two broad groups.

- ☐ Long –term investment decision i.e. Capital budgeting.
- ☐ Short-term investment decision i.e. Working Capital Management.

The evaluation of long-term investment decisions or investment analysis to be consistent with the firm's goal involves the following three basic steps.

1. Estimation or determination of cash flows.
2. Determining the rate of discount or cost of capital.
3. Applying the technique of capital budgeting to determine the viability of the investment proposal.

1. Estimation of relevant cash flows.



If a firm makes an investment today, it will require an immediate cash outlay, but the benefits of this investment will be received in future. There are two alternative criteria available for ascertaining future economic benefits of an investment proposal-

1. Accounting profit
2. Cash flow.

The term accounting profit refers to the figure of profit as determined by the Income statement or Profit and Loss Account, while cash flow refers to cash revenues minus cash expenses. The difference between these two criteria arises primarily because of certain non-cash expenses, such as depreciation, being charged to profit and loss account. Thus, the accounting profits have to be adjusted for such non-cash charges to determine the actual cash inflows. In

fact, cash flows are considered to be better measure of economic viability as compared to accounting profits.

2. Determining the rate of discount or cost of capital.

It is the evaluation of investment decisions on net present value basis i.e. determine the rate of discount .Cost of capital is the minimum rate of return expected by its investors.

3. Applying the technique of capital budgeting to determine the viability of the investment proposal.

Capital Budgeting is the process of making investment decisions in capital expenditures. A capital expenditure may be defined as an expenditure the benefit of which are expected to be received over period of time exceeding one year. Capital Budgeting technique helps to determine the viability of the investment proposal or taking long-term investment decision.

CAPITAL BUDGETING PROCESS:

A Capital Budgeting decision involves the following process :

- 
- (1) Identification of investment proposals.
- (2) Screening the proposals.
- (3) Evaluation of various proposals.
- (4) Fixing priorities.
- (5) Final approval and preparation of capital expenditure budget.
- (6) Implementing proposal.
- (7) Performance review.

The overall objective of capital budgeting is to maximise the profitability of a firm or the return on investment. There are many methods of evaluating profitability of capital investment proposals.

METHODS OF CAPITAL BUDGETING OR EVALUATION OF INVESTMENT PROPOSALS (INVESTMENT APPRAISAL TECHNIQUES)

The various commonly used methods are as follows.

I . Traditional methods

- (1) Pay back period method or pay out or pay off method.(PBP)
- (2) Accounting Rate of Return method or Average Rate of Return. (ARR)

II. Time adjusted method or discounted method

- (3)Net Present Value method.(NPV)
- (4)Profitability Index method (PI)
- (5)Internal Rate of Return method (IRR)
- (6)Net Terminal Value method (NTV)



(1) Pay back period method or pay out or pay off method.(PBP)

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The basic element of this method is to calculate the recovery time, by year wise accumulation of cash inflows (inclusive of depreciation) until the cash inflows equal the amount of the original investment. The time taken to recover such original investment is the “payback period” for the project.

“The shorter the payback period, the more desirable a project”.

The pay back period can be calculated in two different situation as follows-

(a)When annual cash inflow are equal

$$\text{Pay back period} = \frac{\text{Original cost of the project (cash outlay)}}{\text{Annual net cash inflow (net earnings)}}$$

(a) When annual cash inflows are unequal

It is ascertained by cumulating cash inflows till the time when the cumulative cash inflows become equal to initial investment.

$$\text{Pay back period} = Y + \frac{B}{C}$$

Y = No of years immediately preceding the year of final recovery.

B = Balance amount still to be recovered.

C = Cash inflow during the year of final recovery.

Merits of Pay back period :

- 
- (1) No assumptions about future interest rates.
 - (2) In case of uncertainty in future, this method is most appropriate.
 - (3) A company is compelled to invest in projects with shortest payback period, if capital is a constraint.
 - (4) It is an indication for the prospective investors specifying the payback period of their investments.
 - (5) Ranking projects as per their payback period may be useful to firms undergoing liquidity constraints.

Demerits of Pay back period :

- (1) Cash generation beyond payback period is ignored.
- (2) The timing of returns and the cost of capital is not considered.
- (3) The traditional payback method does not consider the salvage value of an investment.

- (4) Percentage Return on the capital invested is not measured.
- (5) Projects with long payback periods are characteristically those involved in long-term planning, which are ignored in this approach.

(2) Accounting Rate of Return method or Average Rate of Return (ARR)

This method measures the increase in profit expected to result from investment.

It is based on accounting profits and not cash flows.

$$ARR = \frac{\text{Average income or return}}{\text{Average investment}} \times 100$$

$$\text{Average investment} = \frac{\text{Original investment} + \text{Salvage value}}{2}$$

Merits of ARR

- (1) This method considers all the years in the life of the project.
- (2) It is based upon profits and not concerned with cash flows.
- (3) Quick decision can be taken when a number of capital investment proposals are being considered.

Demerits of ARR

- (1) Time Value of Money is not considered.
- (2) It is biased against short-term projects.
- (3) The ARR is not an indicator of acceptance or rejection, unless the rates are compared with the arbitrary management target.
- (4) It fails to measure the rate of return on a project even if there are uniform cash flows.

(3) Net Present Value method.(NPV)

NPV= Present Value of Cash Inflows – Present Value of Cash Outflows

The discounting is done by the entity's weighted average cost of capital.

The discounting factors is given by :

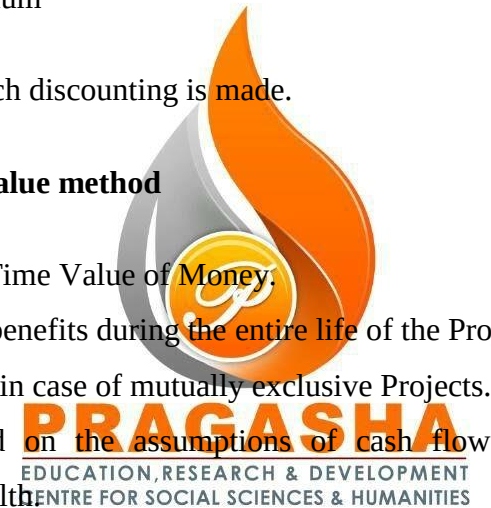
$$\frac{1}{(1+i)^n}$$

Where

i = rate of interest per annum

n = no. of years over which discounting is made.

Merits of Net Present Value method

- 
- (1) It recognises the Time Value of Money.
 - (2) It considers total benefits during the entire life of the Project.
 - (3) This is applicable in case of mutually exclusive Projects.
 - (4) Since it is based on the assumptions of cash flows, it helps in determining Shareholders Wealth.

Demerits of Net Present Value method

- (1) This is not an absolute measure.
- (2) Desired rate of return may vary from time to time due to changes in cost of capital.
- (3) This Method is not effective when there is disparity in economic life of the projects.
- (4) More emphasis on net present values. Initial investment is not given due importance.

(4) Profitability Index method (PI)

Profitability Index = P.V. of cash outflow

P.V . of cash inflow

If $P.I > 1$, project is accepted

$P.I < 1$, project is rejected

The Profitability Index (PI) signifies present value of inflow per rupee of outflow. It helps to compare projects involving different amounts of initial investments.

(5) Internal Rate of Return method (IRR)

Internal Rate of Return is a percentage discount rate applied in capital investment decisions which brings the cost of a project and its expected future cash flows into equality, i.e., NPV is zero.

Decision Rule of IRR

The decision rule for the internal rate of return is to invest in a project if its rate of return is greater than its cost of capital.

For independent projects and situations involving no capital rationing, then:



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Situation	Signifies	Decision
$IRR = \text{Cost of Capital}$	the investment is expected not to change shareholder wealth.	Indifferent between Accepting & Rejecting
$IRR > \text{Cost of Capital}$	The investment is expected to increase shareholders wealth	Accept
$IRR < \text{Cost of Capital}$	The investment is expected to decrease shareholders wealth	Reject

Merits of Internal Rate of Return method :

- (i) The Time Value of Money is considered.
- (ii) All cash flows in the project are considered.

Demerits of Internal Rate of Return method

- (i) Possibility of multiple IRR, interpretation may be difficult.
- (ii) If two projects with different inflow/outflow patterns are compared, IRR will lead to peculiar situations.
- (iii) If mutually exclusive projects with different investments, a project with higher investment but lower IRR contributes more in terms of absolute NPV and increases the shareholders' wealth.

When evaluating mutually exclusive projects, the one with the highest IRR may not be the one with the best NPV.

The conflict between NPV & IRR for the evaluation of mutually exclusive projects is due to the reinvestment assumption:

- NPV assumes cash flows reinvested at the cost of capital.
- IRR assumes cash flows reinvested at the internal rate of return.

The reinvestment assumption may cause different decisions due to :

- Timing difference of cash flows.
- Difference in scale of operations.
- Project life disparity.

(6) Net Terminal Value method (NTV)

Assumption:

- (1) Each cash flow is reinvested in another project at a predetermined rate of interest.
- (2) Each cash inflow is reinvested elsewhere immediately after the completion of the project. Decision-making



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If the P.V. of Sum Total of the Compound reinvested cash flows is greater than the P.V. of the outflows of the project under consideration, the project will be accepted otherwise not.

FINANCING DECISION

The financing decision relates to the composition of relative proportion of various sources of finance. The sources could be:

1. **Shareholders fund:** Equity share capital, Preference share capital, Accumulated profits.
2. **Borrowing from outside agencies:** Debentures, Loans from Financial Institutions.

Whether the companies choose shareholders funds or borrowed funds or a combination of both, each type of fund carries a cost.

The cost of equity is the minimum return the shareholders would have received if they had invested elsewhere. Borrowed funds cost involve interest payment.

Both types of funds incur cost and this is the cost of capital to the company. This means, cost of capital is the minimum return expected by the company.

COST OF CAPITAL AND FINANCING DECISION



James C. Van Horne: The cost of capital is “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 the stock”.

Soloman Ezra : “Cost of Capital is the minimum required rate of earnings or the cut-off rate of capital expenditure”.

It is the discount rate /minimum rate of return/opportunity cost of an investment.

IMPORTANCE OF COST OF CAPITAL :

The cost of capital is very important in financial management and plays a crucial role in the following areas:

i) **Capital budgeting decisions:** The cost of capital is used for discounting cash flows under Net Present Value method for investment proposals. So, it is very useful in capital budgeting decisions.

ii) **Capital structure decisions:** An optimal capital structure is that structure at which the value of the firm is maximum and cost of capital is the lowest. So, cost of capital is crucial in designing optimal capital structure.

iii) **Evaluation of financial performance:** Cost of capital is used to evaluate the financial performance of top management. The actual profitability is compared to the expected and actual cost of capital of funds and if profit is greater than the cost of capital the performance may be said to be satisfactory.

iv) **Other financial decisions:** Cost of capital is also useful in making such other financial decisions as dividend policy, capitalization of profits, making the rights issue, etc.

Explicit and Implicit Cost: *Explicit cost* of any source of finance is the discount rate which equates the present value of cash inflows with the present value of cash outflows. It is the internal rate of return.

Implicit cost also known as the opportunity cost is the opportunity foregone in order to take up a particular project. For example, the implicit cost of retained earnings is the rate of return available to shareholders by investing the funds elsewhere.

ESTIMATION OF COMPONENTS OF COST OF CAPITAL

Components of cost of capital includes individual source of finance in business. From the viewpoint of capital budgeting decisions, the long term sources of funds are relevant as they constitute the major sources of financing the fixed assets. In calculating the cost of capital, therefore components include-

1. Long term debt (including Debentures)
2. Preference capital
3. Equity Capital.
4. Retained Earnings
5. Weighted Average Cost of Capital
6. Marginal Cost of Capital

1. Cost of Debt (kd) (Long term debt (including Debentures))

Debt may be perpetual or redeemable debt. Moreover, it may be issued at par, at premium or discount. The computation of cost of debt in each is explained below.

Perpetual / irredeemable debt:

$K_d = \text{Cost of debt before tax} = \frac{I}{NP}$

K_d = Cost of debt; I = interest; NP = Net Proceeds

$$k_d(\text{after-tax}) = \frac{I}{NP} (1-t)$$

Where t = tax rate

Redeemable debt

The debt repayable after a certain period is known as redeemable debt.

$$i) \quad \text{Before-tax cost of debt} = \frac{I + \frac{1}{n}(P - NP)}{\frac{1}{2}(P + NP)}$$

I = interest : P = proceeds at par;

NP = net proceeds; n = No. of years in which debt is to be redeemed

$$ii) \quad \text{After tax cost of debt} = \text{Before – tax cost of debt} \times (1-t)$$

2. Cost of Preference Capital (kP)

In case of preference share dividend are payable at a fixed rate. However, the dividends are allowed to be deducted for computation of tax. So no adjustment for tax is required. Just like debentures, preference share may be perpetual or redeemable. Further, they may be issued at par, premium or discount.

Perpetual Preference Capital

i) If issued at par; $K_p = D/P$

K_p = Cost of preference capital

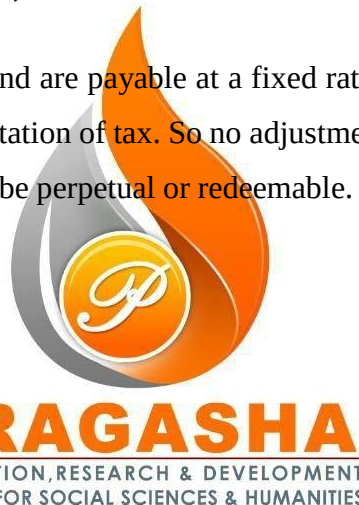
D = Annual preference dividend

P = Proceeds at par value

ii) If issued at premium or discount

$K_p = D/NP$ Where NP = Net Proceeds.

3. Cost of Equity capital



Cost of Equity is the expected rate of return by the equity shareholders. Some argue that, as there is no legal compulsion for payment, equity capital does not involve any cost. But it is not correct. Equity shareholders normally expect some dividend from the company while making investment in shares. Thus, the rate of return expected by them becomes the cost of equity. Conceptually, cost of equity share capital may be defined as the minimum rate of return that a firm must earn on the equity part of total investment in a project in order to leave unchanged the market price of such shares. For the determination of cost of equity capital it may be divided into two categories:

- i) External equity or new issue of equity shares.
- ii) Retained earnings.

The cost of external equity can be computed as per the following approaches:

Dividend Yield / Dividend Price Approach : According to this approach, the cost of equity will be that rate of expected dividends which will maintain the present market price of equity shares. It is calculated with the following formula :

$$K_e = D/NP \text{ (for new equity shares)}$$

Or

$$K_e = D/MP \text{ (for existing shares)}$$

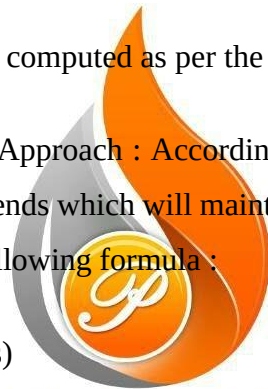
Where,

K_e = Cost of equity

D = Expected dividend per share

NP = Net proceeds per share

MP = Market price per share



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This approach rightly recognizes the importance of dividends. However, it ignores the importance of retained earnings on the market price of equity shares. This method is suitable only when the company has stable earnings and stable dividend policy over a period of time.

Dividend yield plus Growth in dividend methods

According to this method, the cost of equity is determined on the basis of the expected dividend rate plus the rate of growth in dividend. This method is used when dividends are expected to grow at a constant rate.

Cost of equity is calculated as:

$$K_e = D_1 / NP + g \text{ (for new equity issue)}$$

Where,

D_1 = expected dividend per share at the end of the year. [$D_1 = D_0(1+g)$] NP = net proceeds per share

g = growth in dividend for existing share is calculated as:

$$D_1 / MP + g$$

Where,

MP = market price per share.

Earnings Yield Method –

According to this approach, the cost of equity is the discount rate that capitalizes a stream of future earnings to evaluate the shareholdings. It is computed by taking earnings per share (EPS) into consideration. It is calculated as :

$$i) K_e = \text{Earnings per share} / \text{Net proceeds} = EPS / NP \text{ [For new share]}$$

$$ii) K_e = EPS / MP \text{ [For existing equity]}$$



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4. Cost of Retained Earnings (Kr)

Retained earnings refer to undistributed profits of a firm. Out of the total earnings, firms generally distribute only part of them in the form of dividends and the rest will be retained within the firms. Since no dividend is required to be paid on retained earnings, it is stated that 'retained earnings carry no cost'. But this approach is not appropriate. Retained earnings have the opportunity cost of dividends in alternative investment, which becomes cost of retained earnings. Hence, shareholders expect a return on retained earnings at least equity.

$$K_r = K_e = D/NP + g$$

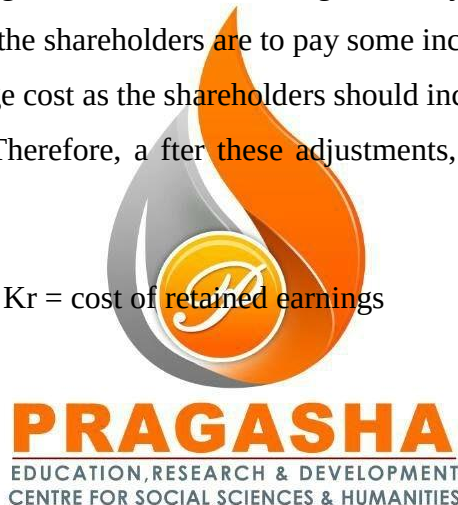
However, while calculating cost of retained earnings, two adjustments should be made :a) Income-tax adjustment as the shareholders are to pay some income tax out of dividends, and b) adjustment for brokerage cost as the shareholders should incur some brokerage cost while investing dividend income. Therefore, after these adjustments, cost of retained earnings is calculated as :

$$K_r = K_e (1-t)(1-b) \text{ Where, } K_r = \text{cost of retained earnings}$$

$$K_e = \text{Cost of equity}$$

$$t = \text{rate of tax}$$

$$b = \text{cost of purchasing new securities or brokerage cost.}$$



5. Weighted Average Cost of Capital

It is the average of the costs of various sources of financing. It is also known as composite or overall or average cost of capital.

After computing the cost of individual sources of finance, the weighted average cost of capital is calculated by putting weights in the proportion of the various sources of funds to the total funds. Weighted average cost of capital is computed by using either of the following two types of weights:

1) Market value 2) Book Value

Market value weights are sometimes preferred to the book value weights as the market value represents the true value of the investors. However, market value weights suffer from the following limitations:

- i) Market value are subject to frequent fluctuations.
- ii) Equity capital gets more importance, with the use of market value weights. Moreover, book values are readily available.

Average cost of capital is computed as followings:

$$K_w = \frac{\sum x}{\sum w}$$

Where, K_w = weighted average cost of capital

X = cost of specific sources of finance

W = weights (proportions of specific sources of finance in the total)

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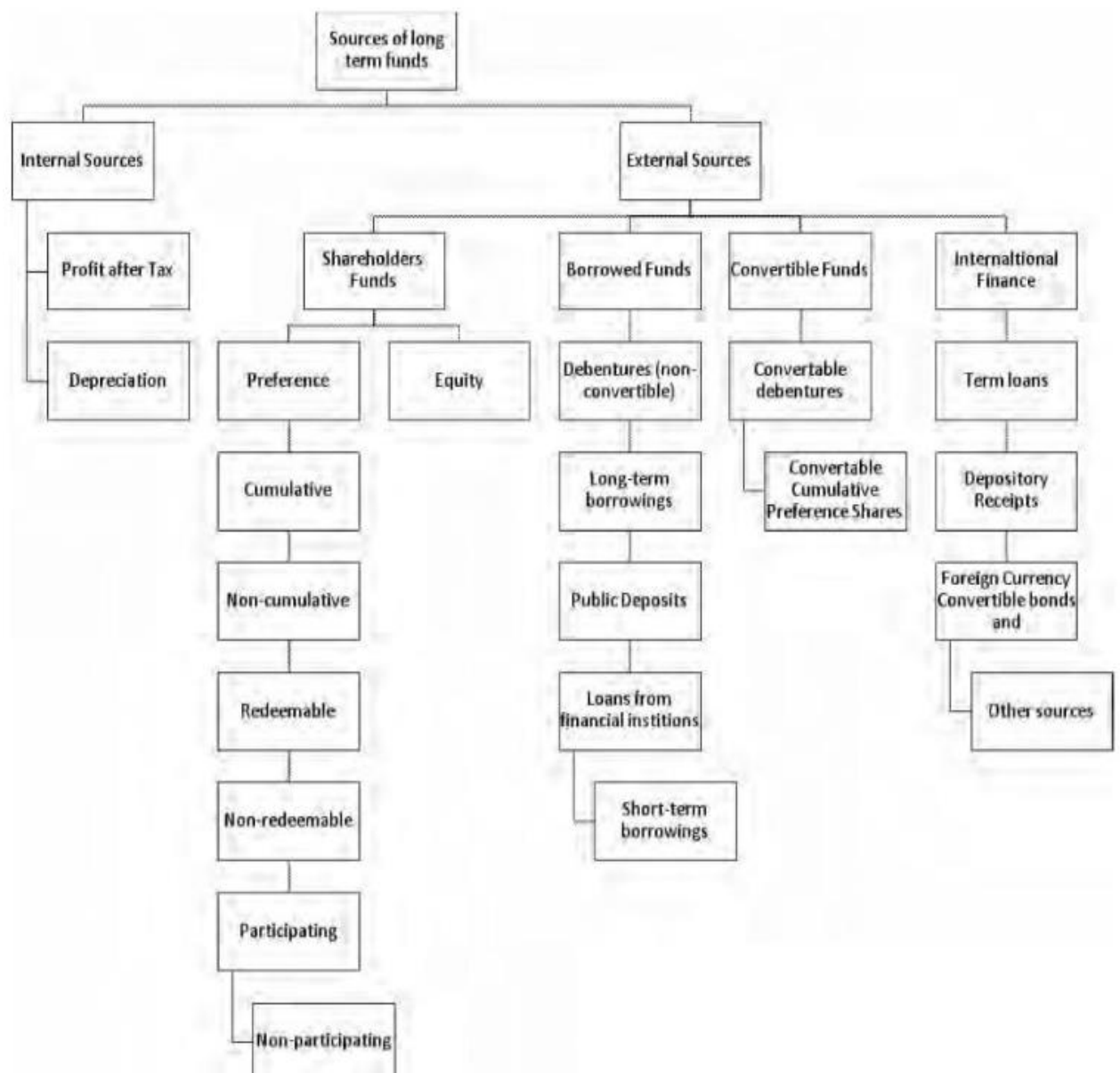
The following steps are involved in the computation of weighted average cost of capital:

- i) Multiply the cost of each sources with the corresponding weight.
- ii) Add all these weighted costs so that weighted average cost of capital is obtained.

6. Marginal Cost of Capital

An average cost is the combined cost or weighted average cost of various sources of capital. Marginal cost refers to the average cost of capital of new or additional funds required by a firm. It is the marginal cost which should be taken into consideration in investment decisions.

Source of Long Term Fund



LONG TERM SOURCES OF FUNDS:

Companies raise long term funds from the capital markets. Funds available for a period of less than one year are short term funds. With the increase in cross-border transactions, international sources of funds are also available. An effective trade-off between the domestic funds and international funds shall contribute towards increasing profitability and wealth maximisation

To enable the investments, creation of assets and infrastructure, an organisation require long term sources of funds. They are:

1. Equity Share Capital

Equity share capital is a basic source of finance for any Company. It represents the ownership interest in the company. The characteristics of equity share capital are a direct consequence of its position in the company's control, income and assets. Equity share capital does not have any maturity nor there any compulsion to pay dividend on it. The equity share capital provides funds, more or less, on a permanent basis. It also works as a base for creating the debt and loan capacity of the firm. The advantages and limitations of equity share capital may be summarized as follows

Advantages of Equity Share Financing



- a. Since equity shares do not mature, it is a permanent source of fund. However, a company, if it so desires, can retire shares through buy-back as per the guidelines issued by the SEBI.
- b. The new equity share capital increases the corporate flexibility from the point of view of capital structure planning. One such strategy may be to retire debt financing out of the funds received from the issue of equity capital.
- c. Equity share capital does not involve any mandatory payments to shareholders.
- d. It may be possible to make further issue of share capital by using a right offering. In general, selling right shares involves no change in the relationship between ownership and

control. Existing shareholders can maintain their proportionate holding by exercising their pre-emptive right.

Limitations of Equity Share Financing

- a. The equity share capital has the highest specific cost of capital among all the sources. This necessitates that the investment proposals should also have equally high rate of return.
- b. Equity dividends are paid to the shareholders out of after-tax profits. These dividends are not tax deductible, rather imply a burden of Corporate Dividend tax on the company.
- c. At times, the new issue of equity capital may reduce the EPS and thus may have an adverse effect on the market price of the equity share.
- d. Excessive issue of equity share can dilute the ownership of the Company.

2. Preference Share Capital

The preference share capital is also owner's capital but has a maturity period. In India, the preference shares must be redeemed within a maximum period of 20 years from the date of issue. The rate of dividend payable on preference shares is also fixed. As against the equity share capital, the preference shares have two references: (i) Preference with respect to payment of dividend, and (ii) Preference with reference to repayment of capital in case of liquidation of company.

However, the preference share capital represents an ownership interest and not a liability of the company. The preference shareholders have the right to receive dividends in priority over the equity shareholders. Indeed, it is this preference which distinguishes preference shares from equity shares. A dividend need not necessarily be paid on either type of shares. However, if the directors want to pay equity dividend, then the full dividend due on the preference shares must be paid first. Failure to meet commitment of preference dividend is not a ground for liquidation. The advantages and disadvantages of the preference share capital are as follows:

Advantages of Preference Share Financing

- a. The preference shares carry limited voting right though they are a part of the capital. Thus, these do not present a major control or ownership problem as long as the dividends are paid to them.
- b. As an instrument of financing, the cost of capital of preference shares is less than that of equity shares.
- c. The preference share financing may also provide a hedge against inflation because the fixed financial commitment which is unaffected by the inflation.
- d. As there is no legal compulsion to pay preference dividend, a company does not face liquidation or other legal proceedings if it fails to pay the preference dividends.

Limitations of Preference Share Financing

- a. The cost of capital of preference shares is higher than cost of debt.
- b. Though there is no compulsion to pay preference dividend, yet the non-payment may adversely affect the market price of the equity shares and hence affect the value of the firm.
- c. The compulsory redemption of preference shares after 20 years will entail a substantial cash outflow from the company.
- d. If the company is not able to earn a return at least equal to the cost of preference share capital, then it may result in decrease in EPS for the equity shareholders.

3. Debentures

A bond or a debenture is the basic debt instrument which may be issued by a borrowing company for a price which may be less than, equal to or more than the face value. A debenture also carries a promise by the company to make interest payments to the debenture-holders of specified amount, at specified time and also to repay the principal amount at the end of a specified period. Since the debt instruments are issued keeping in view the need and cash flow profile of the company as well as the investor, there have

been a variety of debt instruments being issued by companies in practice. In all these instruments, the basic features of being in the nature of a loan are not dispensed with and, therefore, these instruments have some or the other common features as follows:

- (i) Credit Instrument—A debenture-holder is a creditor of the company and is entitled to receive payments of interest and the principal and enjoys some other rights.
- (ii) Interest Rate— In most of the cases, the debt securities promise a rate of interest payable periodically to the debt holders. The rate of interest is also denoted as coupon rate.
- (iii) Collateral— Debt issue may or may not be secured and, therefore, debentures or other such securities may be called secured debentures or unsecured debentures.
- (iv) Maturity Date— All debt instruments have a fixed maturity date, when these will be repaid or redeemed in the manner specified.
- (v) Voting Rights— As the debt holders are creditors of the company, they do not have any voting right in normal situations.
- (vi) Face Value— every debt instrument has a face value as well as a maturity value.
- (vii) Priority in Liquidation— In case of liquidation of the company, the claim of the debt holders is settled in priority over all shareholders and, generally, other unsecured creditors also.

In practice, different types of debentures have been issued. These are :

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- (a) Convertible Debentures— In this case, the debentures are converted, fully or partially, into equity shares some time after the date of issue.
- (b) Non-convertible Debentures— These debentures remain a debt security till maturity. Interest is paid on these debentures as per terms and conditions.
- (c) Innovative Debentures— Companies have come forward to issue a debt security with different attractive and innovative features. Some of these are – Secured Premium Notes, Optionally Convertible Debentures, Triple Option Convertible Debentures, etc. Financial Institutions such as IDBI have issued Deep

Discount Bonds (DDBs) from time to time to procure funds for a longer period.

4. Lease and Hire Purchase

Instead of procuring funds, and purchasing the equipment, a firm can acquire the asset itself on lease. In this case, the asset is financed by the lessor but the lessee gets the asset for use. In case of hire purchase, the assets are acquired on credit and payments are made as per terms and conditions.

5. Term Loans

This is also an important source of long-term financing. There are different financial institutions (National level as well as State level) which provide financial assistance for taking up projects. These can be broadly divided into All India Financial Institutions and State level Financial Institutions. The All India Institutions are:-

- i) Industrial Finance Corporation of India, (IFCI)
- ii) Industrial Credit and Investment Corporation in India (ICICI),
- iii) Industrial Development Bank of India (IDBI),
- iv) Life Insurance Corporation of India,
- v) Industrial Reconstruction Corporation of India,
- vi) Unit Trust of India,
- vii) National Small Industries Corporation Ltd.(NSIC)

The state level institutions are the State Finance Corporations and the State Industrial Development Corporations.



6. Official Foreign Source of Finance

1. Foreign Collaboration: In India joint participation of foreign and domestic capital has been quite common in recent years. Foreign collaboration could be either in the form of joint participation between private firms, or between foreign firms and Indian Government, or between foreign governments and Indian Government.
2. Bilateral Government Funding Arrangement: Generally, advanced countries provide aid in the form of loans and advances, grants, subsidies to governments of under-developed and developing countries. The aid is provided usually for financing government and public sector projects. Funds are provided at concessional terms in respect of cost (interest), maturity, and repayment schedule.

3. **NRI Deposits and Investments:** on-resident Indian have always been making a contribution in Indian economy. Government has been making efforts to encourage their deposits and investments. Various schemes have been devised which ensure higher returns; procedures have been simplified to attract investments in primary and secondary market. Tax incentives are given on interest earned and dividends received by NRIs.
4. **Loans from International Financial Institutions:** International Bank for Reconstruction and Development (IBRD), International Monetary Fund (IMF), Asian Development Bank (ADB), and World Bank have been the major source of external finance to India.
5. **External Commercial Borrowing (CEB):** Our country has also been obtaining foreign capital in the form of external commercial borrowings from agencies like US EXIM Bank, ECGC of UK, etc.

7. Non Official Foreign Source of Finance:

Foreign Direct Investment (FDI)

Foreign direct investment is one of the most important sources of foreign investment in developing countries like India. It is seen as a means to supplement domestic investment for achieving a higher level of growth and development. FDI is permitted under the forms of investments.



1. Through financial collaborations / capital / equity participation;
2. Through Joint ventures and technical collaborations;
3. Through capital markets (Euro Issues);
4. Through private placements or preferential allotment.

Capital participation / financial collaboration refers to the foreign partner's stake in the capital of the receiving country's companies while technical collaboration refers to such facilities provided by foreign partner as licencing, trade marks and patents (against which he gets lump sum fee or royalty payments for specified period); technical services etc.

From investors' point of view, the FDI inflows can be classified into the following groups.

- (a) Market seeking: The investors are attracted by the size of the local market, which depends on the income of the country and its growth rate.
- (b) Lower cost: Investors are more cost-conscious. They are influenced by infrastructure facilities and labour costs.
- (c) Location and other factors : Technological status of a country, brand name, goodwill enjoyed by the local firms, favourable location, openness of the economy, policies of the government and intellectual property protection granted by the government are some of the factors that attract investors to undertake investments.

SHORT TERM FUNDS:

Short term funds are usually required for working capital; to operate the project after it is completed. The working capital consists of the margin to be provided by the entrepreneur and the bulk of the balance is borrowed from a commercial bank or some other source as short term finance. The margin to be provided by the entrepreneur is included in the project cost estimates and is financed from the various means of financing discussed earlier. The main sources of working capital are :-

1. Commercial banks,
2. The type of debentures issued for meeting working capital requirements are usually then on-convertible debentures.
3. Public Deposit
4. Commercial Paper
5. Supplier' Credit
6. Foreign currency funds etc.

CAPITALISATION, CAPITAL STRUCTURE, FINANCIAL STRUCTURE

Capitalisation is a quantitative aspect of the financial planning of an enterprise, capital structure is concerned with the qualitative aspect. Capitalisation refers to the total amount of securities issued by a company while capital structure refers to the kind of securities and the proportionate amount that make up capitalisation. Financial structure refers to all

the financial resources marshalled by the firm ,short as well as long –term ,and all forms of debt and equity.

Capital and Capitalisation

The term capital refers to the total investment of a company in money, tangible and intangible assets. It is the total wealth of a company . The term Capitalisation is used only in relation to companies and not in relation to partner ship firms or sole- proprietary organisations. Capitalisation refers to the par value of securities i.e. share, debenture &reserves.

Over Capitalisation- It refers to that state of affairs where earning of a company do not justify the amount of capital invested in its business.

Under Capitalisation-It occurs when a companies actual capitalisation is lower than its proper capitalisation as warranted by its earning capacity.

Fair Capitalisation-It is neither over capitalisation nor under capitalisation.

The term capital structure refers to the relationship between the various long –term forms of financing such as debenture ,preference share capital and equity share capital .Financing the firm's asset is a very crucial problem in every business and as a general rule there should be a proper mix of debt and equity capital in financing the firms assets. The use of long term fixed interest bearing debt and preference share capital along with equity share is called financial leverage or trading on equity.

Capital gearing means the ratio between the various types of securities in the capital structure of the company .A company is said to be in high gear ,when it has a proportionately higher/large issue of debentures and preference shares for raising the long term resources ,whereas low-gear stands for a proportionately large issue of equity shares.

Capital Structure Theory

The capital structure of a company refers to a combination of the long-term finances used by the firm. The theory of capital structure is closely related to the firm's cost of capital. The decision regarding the capital structure or the financial leverage or the financing is

based on the objective of achieving the maximization of shareholders wealth. To design capital structure, we should consider the following two propositions:

- (i) Wealth maximization is attained.
- (ii) Best approximation to the optimal capital structure.

Factors Determining Capital Structure

(1) Minimization of Risk :

- Capital structure must be consistent with business risk.
- It should result in a certain level of financial risk.

(2) Control : It should reflect the management's philosophy of control over the firm.

(3) Flexibility : It refers to the ability of the firm to meet the requirements of the changing situations.

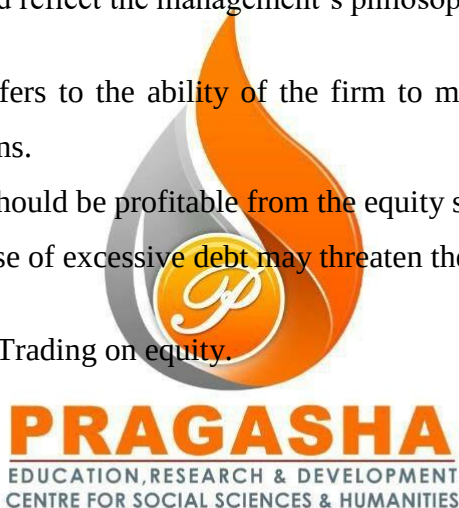
(4) Profitability : It should be profitable from the equity shareholders point of view.

(5) Solvency : The use of excessive debt may threaten the solvency of the company.

(6) Financial leverage or Trading on equity.

(7) Cost of capital.

(8) Nature and size of the firm.



Process of Capital Structure Decisions

Capital Budgeting Decision



Long-term sources of funds



Capital Structure Decision



Debt-Equity



Effect on Cost of Capital

Value of the Firm

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THEORIES OF CAPITAL STRUCTURE:
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Equity and debt capital are the two major sources of long-term funds for a firm. The theories of capital structure suggest the proportion of equity and debt in the capital structure.

Assumptions

- (i) There are only two sources of funds, i.e., the equity and the debt, having a fixed interest.
- (ii) The total assets of the firm are given and there would be no change in the investment decisions of the firm.
- (iii) EBIT (Earnings Before Interest & Tax)/NOP (Net Operating Profits) of the firm are given and is expected to remain constant.

- (iv) Retention Ratio is NIL, i.e., total profits are distributed as dividends. [100% dividend pay-out ratio]
- (v) The firm has a given business risk which is not affected by the financing decision.
- (vi) There is no corporate or personal taxes.
- (vii) The investors have the same subjective probability distribution of expected operating profits of the firm.
- (viii) The capital structure can be altered without incurring transaction costs.

In discussing the theories of capital structure, we will consider the following notations :

E = Market value of the Equity

D = Market value of the Debt

V = Market value of the Firm = $E + D$

I = Total Interest Payments

T = Tax Rate

$EBIT/NOP$ = Earnings before Interest and Tax/Net Operating Profit
 PAT = Profit After Tax

D_0 = Dividend at time 0 (i.e. now)

D_1 = Expected dividend at the end of Year 1.

P_0 = Current Market Price per share

P_1 = Expected Market Price per share at the end of Year 1.

Different Theories of Capital Structure

- (1) Net Income (NI) approach
- (2) Net Operating Income (NOI) Approach



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- (3) Traditional Approach
- (4) Modigliani-Miller Model
 - (a) without taxes
 - (b) with taxes.

Net Income Approach

As suggested by David Durand, this theory states that there is a relationship between the Capital Structure and the value of the firm.

Assumptions

- (1) Total Capital requirement of the firm are given and remain constant
- (2) $K_d < K_e$
- (3) K_d and K_e are constant
- (4) K_o decreases with the increase in leverage

NET OPERATING INCOME (NOI) APPROACH

According to David D urand, under NOI approach, the total value of the firm will not be affected by the composition of capital structure.

Assumptions

- 1. K_o and K_d are constant.
- 2. K_e will change with the degree of leverage.
- 3. There is no tax.

Traditional Approach:

It takes a mid-way between the NI approach and the NOI approach Assumptions

- i. The value of the firm increases with the increase in financial leverage, upto a certain limit only.
- ii. K_d is assumed to be less than K_e .

Modigliani – Miller (MM) Hypothesis



The Modigliani – Miller hypothesis is identical with the Net Operating Income approach. Modigliani and Miller argued that, in the absence of taxes the cost of capital and the value of the firm are not affected by the changes in capital structure. In other words, capital structure decisions are irrelevant and value of the firm is independent of debt – equity mix.

Basic Propositions

M - M Hypothesis can be explained in terms of two propositions of Modigliani and Miller. They are :

- i. The overall cost of capital (KO) and the value of the firm are independent of the capital structure. The total market value of the firm is given by capitalising the expected net operating income by the rate appropriate for that risk class.
- ii. The financial risk increases with more debt content in the capital structure. As a result cost of equity (K_e) increases in a manner to offset exactly the low – cost advantage of debt. Hence, overall cost of capital remains the same.

Assumptions of the MM Approach

1. There is a perfect capital market. Capital markets are perfect when
 - i) investors are free to buy and sell securities,
 - ii) they can borrow funds without restriction at the same terms as the firms do,
 - iii) they behave rationally,
 - iv) they are well informed, and
 - v) there are no transaction costs.
2. Firms can be classified into homogeneous risk classes. All the firms in the same risk class will have the same degree of financial risk.
3. All investors have the same expectation of a firm's net operating income (EBIT).
4. The dividend payout ratio is 100%, which means there are no retained earnings.

LEVERAGE

The concept of leverage has its origin in science. It means influence of one force over another. Since financial items are inter-related, change in one, causes change in profit. In

the context of financial management, the term 'leverage' means sensitiveness of one financial variable to change in another. The measure of this sensitiveness is expressed as a ratio and is called degree of leverage. Algebraically, the leverage may be defined as,

$$\text{Leverage} = \frac{\% \text{ Change in one variable}}{\% \text{ Change in some other variable}}$$

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CONCEPT AND NATURE OF LEVERAGES OPERATING RISK AND FINANCIAL RISK AND COMBINED LEVERAGE:

The concept of leverage has its origin in science. It means influence of one force over another. Since financial items are inter-related, change in one, causes change in profit. In the context of financial management, the term 'leverage' means sensitiveness of one financial variable to change in another. The measure of this sensitiveness is expressed as a ratio and is called degree of leverage.

Measures of Leverage

To understand the concept of leverage, it is imperative to understand the three measures of leverage

- (i) Operating Leverage
- (ii) Financial Leverage
- (iii) Combined Leverage

In explaining the concept of leverage, the following symbols and relationship shall be used :

Number of units produced and sold = Q

Sale Price per unit = S

Total Sale Value or Total Revenue = SQ

Variable Cost per unit = V

Total Variable Cost = VQ

Total Contribution = Total Revenue – Total Variable Cost Number

$$= SQ - VQ$$

$$= Q(S - V)$$

$$\begin{aligned}\text{Contribution per unit} &= \frac{\text{Total Contribution}}{\text{Units sold}} \\ &= \frac{Q(S - V)}{Q} = S - V = C\end{aligned}$$

Earning before Interest and Tax = EBIT

$$= \text{Total Contribution} - \text{Fixed Cost If, Fixed Cost} = F$$

Then, EBIT = Q (S – V) – F

$$= CQ - F. \text{ (Here, CQ denotes contribution)}$$

Operating Leverage



It is important to know how the operating leverage is measured, but equally essential is to understand its nature in financial analysis.

Operating leverage reflects the impact of change in sales on the level of operating profits of the firm.

The significance of DOL may be interpreted as follows :

- Other things remaining constant, higher the DOL, higher will be the change in EBIT for same change in number of units sold in, if firm A has higher DOL than firm B, profits of firm A will increase at faster rate than that of firm B for same increase in demand.

This however works both ways and so losses of firm A will increase at faster rate than that of firm B for same fall in demand. This means higher the DOL, more is the risk.

- DOL is high where contribution is high.

- There is an unique DOL for each level of output.

Operating Leverage examines the effect of the change in the quantity produced on the EBIT of the Company and is measured by calculating the degree of operating leverage (DOL). The degree of operating leverage is therefore ratio between proportionate change in EBIT and corresponding proportionate change in Q.

$$DOL = \frac{CQ}{CQ-F} = \frac{\text{Contribution}}{EBIT}$$



Financial Leverage

The Financial leverage may be defined as a % increase in EPS associated with a given percentage increase in the level of EBIT. Financial leverage emerges as a result of fixed financial charge against the operating profits of the firm. The fixed financial charge appears in case the funds requirement of the firm is partly financed by the debt financing. By using this relatively cheaper source of finance, in the debt financing, the firm is able to magnify the effect of change in EBIT on the level of EPS. The significance of DFL may be interpreted as follows:

- Other things remaining constant, higher the DFL, higher will be the change in EPS for same change in EBIT. In other words, if firm K has higher DFL than firm L, EPS of firm K increases at faster rate than that of firm L for same increase in EBIT. However, EPS of firm

K falls at a faster rate than that of firm K for same fall in EBIT. This means, higher the DFL more is the risk.

-Higher the interest burden, higher is the DFL, which means more a firm borrows more is its risk.

- Since DFL depends on interest burden, it indicates risk inherent in a particular capital mix, and hence the name financial leverage.

There is an unique DFL for each amount of EBIT.

While operating leverage measures the change in the EBIT of a company to a particular change in the output, the financial leverage measures the effect of the change in EBIT on the EPS of the company.

Thus the degree of financial leverage (DFL) is ratio between proportionate change in EPS and proportionate change in EBIT.

$$EPS = \frac{(EBIT - I)(1 - T) - D}{N}$$

Where I = Interest

t = Tax rate

D = Preference Dividend

N = No of equity shares.

$$DFL = \frac{\frac{\Delta EPS}{EPS}}{\frac{\Delta EBIT}{EBIT}}$$

Substituting the value of EPS above, we have

$$DFL = \frac{EBIT(1 - t)}{(EBIT - I)(1 - t) - D}$$

If there is no preference share capital,

$$DFL = \frac{EBIT}{EBIT - I} = \frac{\text{Earning before interest and tax}}{\text{Earning after interest}}$$

EBIT-I=Profit Before Tax (PBT)



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Combined Leverage

The operating leverage explains the business risk of the firm whereas the financial leverage deals with the financial risk of the firm. But a firm has to look into the overall risk or total risk of the firm, which is business risk plus the financial risk.

One can draw the following general conclusion about DCL.

- Other things remaining constant, higher the DCL, higher will be the change in EPS for same change in Q (Demand).
- Higher the DCL, more is the overall risk, and higher the fixed cost and interest burden lower is the earning after interest, and higher is the DCL.
- There is a unique DCL, for each level of Q.

A combination of the operating and financial leverages is the total or combination leverage.

The operating leverage causes a magnified effect of the change in sales level on the EBIT level and if the financial leverage combined simultaneously, then the change in EBIT will, in turn, have a magnified effect on the EPS. A firm will have wide fluctuations in the EPS for even a small change in the sales level. Thus effect of change in sales level on the EPS is known as combined leverage.

Thus Degree of Combined leverage may be calculated as follows :

$$DOL = \frac{\text{Contribution}}{EBIT}$$

$$DFL = \frac{EBIT}{EBIT - I} = \frac{\text{Earning before interest and tax}}{\text{Earning after interest}}$$

$$DCL = \frac{\text{Contribution}}{EBIT} \times \frac{EBIT}{EBIT - I} = \frac{C}{EBIT - I}$$

DIVIDEND DECISION

The term dividend refers to that part of profits of a company which is distributed by the company among its shareholders. It is the reward of the shareholders for investments made by them in the shares of the company. The investors are interested in earning the maximum return on their investments and to maximize their wealth. A company, on the other hand, needs to provide funds to finance its long-term growth. If a company pays out as dividend most of what it earns, then for business requirements and further expansion it will have to depend upon outside resources such as issue of debt or new shares. Dividend policy of a firm, thus affects both the long-term financing and the wealth of shareholders. As a result, the firm's decision to pay dividends must be reached in such a manner so as to equitably apportion the distributed profits and retained earnings. Since dividend is a right of Shareholders to participate in the profits and surplus of the company for their investment in the share capital of the company, they should receive fair amount of the profits. The company should, therefore, distribute a reasonable amount as dividends (which should include a normal rate of interest plus a return for the risks assumed) to its members and retain the rest for its growth and survival.

DIVIDEND DECISION AND VALUATION OF FIRM :

The value of the firm can be maximized if the shareholders wealth is maximized. There are conflicting views regarding the impact of dividend decision on the valuation of the firm. According to one school of thought dividend decision does not affect the shareholders' wealth and hence the valuation of the firm. On the other hand, according to the other school of thought, dividend decision materially affects the shareholders' wealth and also the valuation of the firm. We have discussed below the views of the two schools of thought under two groups:

a. The Relevance Concept of Dividend or the Theory of Relevance

b. The Irrelevance Concept of Dividend or the Theory of Irrelevance maximized

The Relevance Concept of Dividends: According to this school of thought, dividends are relevant and the amount of dividend affects the value of the firm. Walter, Gordon and others propounded that dividend decisions are relevant in influencing the value of the firm. Walter argues that the choices of dividend policies almost and always affect the value of the enterprise. The Irrelevance Concept of Dividend : The other school of thought

propounded by Modigliani and Miller in 1961. According to MM approach, the dividend policy of a firm is irrelevant and it does not affect the wealth of the shareholders. They argue that the value of the firm depends on the market price of the share; the dividend decision is of no use in determining the value of the firm.

WALTER'S MODEL :

Walter's model, one of the earlier theoretical models, clearly indicates that the choice of appropriate dividend policy always affects the value of the enterprise. Professor James E. Walter has very scholarly studied the significance of the relationship between the firm's internal rate of return, r , (or actual capitalization rate) and its Cost of Capital, K_e (normal capitalization rate) in determining such dividend policy as will maximize the wealth of the stockholders.

Walter's model is based on the following premises:

- 
- (1) The firm finance its entire investments by means of retained earnings. New equity stock or debenture is not issued to raise funds.
 - (2) Internal rate of return (r) and cost of capital (K_e) of the firm remain constant.
 - (3) The firm's earnings are either distributed as dividends or reinvested internally.
- 
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- (4) Earnings and dividends of the firm never change.
 - (5) The firm has long or infinite life.

The formula used by Walter to determine the market price per share is :

$$P = \frac{D + \frac{r}{k}(E - D)}{k}$$

Where,

P = Market price per share

D = Dividend per share

E = Earnings per share

r = Internal rate of return (Actual capitalization rate)

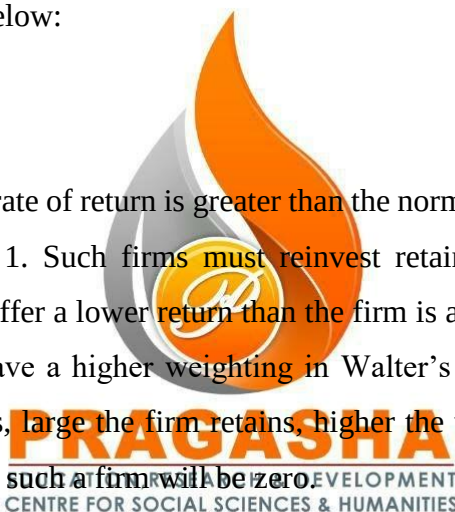
K = Cost capital (External capitalization rate)

It may be noted that Walter's formula has the same effect as the continuing dividend growth formula. It seeks to measure the effect of dividends on common stock value by comparing actual and normal capitalization rates.

Another feature of Walter's formula is that it provides an added or reduced Weight to the retained earnings portion of the capitalization earnings formula. The factors 'r' and 'k' are placed in front of retained earnings to change its weighted value under different situations as discussed below:

1. Growth Firms

In growth firms internal rate of return is greater than the normal rate ($r > k$). Therefore, r/k factor will be greater than 1. Such firms must reinvest retained earnings since existing alternative investments offer a lower return than the firm is able to secure. Each rupee of retained earnings will have a higher weighting in Walter's formula than a comparable rupee of dividends. Thus, large the firm retains, higher the value of the firm. Optimum dividend payout ratio for such a firm will be zero.



2. Normal Firm

Normal firms comprise those firms whose internal rate of return is equal to normal capitalization ($r=k$). These firms earn on their investments rate of return equal to market rate of return. For such firms dividend policy will have no effect on the market value per share in the Walter's model. Accordingly, retained earnings will have the same weighted value as dividends. In this case the market value per share is affected by the payout ratio.

3. Declining Firms

Firms which earn on their investments less than the minimum rate required are designated as declining firms. The management of such firms would like to distribute its earnings to the stockholders so that they may either spend it or invest elsewhere to earn higher return

than earned by the declining firms. Under such a situation each rupee of retained earnings will receive lower weight than dividends and market value of the firm will tend to be maximum when it does not retain earnings at all.

4. Evaluation of the Walter's Model

Professor Walter has endeavoured to show in an erudite manner the effects of dividend policy on value of equity shares under different situations of a firm. However, the basic premises on which edifice of the theory are laid down are unrealistic and therefore, conclusions drawn from the Walter's model are hardly true for real life situations. Thus, for instance assume that a firm finances its investment opportunities only by means of internal sources and no external financing is resorted to for this purpose. Under such a situation, either the value of the firm's investment or dividend or both will be sub-optimum. In its attempt to maximize the value of the firm, the management should go on making investments so long as return of investment is equal to the cost of capital. This is the optimum level of investment; the remaining amount should be raised from external sources. On the contrary, Walter argues that value of the firm is maximized by retaining all the profits because magnitude of investments financed by retained earnings may be less than the optimum level of investment.

Further, Professor Walter has assumed that 'r' remains constant under all the situations. As a matter of fact, 'r' tends to decrease in correspondence with increase in level of investments. This is why it is suggested that the management should make investments upto optimal level where $r = k$.

Finally, assumption of constant cost of capital k is incorrect. On the contrary, it varies in tune with change in risk of the firm.

GORDON'S MODEL :

Myron Gordon has also developed a model on the lines of Prof. Walter suggesting that dividends are relevant and the dividend decision of the firm affects its value. His basic valuation model is based on the following assumptions:

1. The firm is an all equity firm.

2. No external financing is available or used. Retained earnings represent the only source of financing investment programmes.
3. The rate of return on the firm's investment r , is constant.
4. The retention ratio, b , once decided upon is constant. Thus, the growth rate of the firm $g = br$, is also constant.
5. The cost of capital for the firm remains constant and it is greater than the growth rate, i.e. $k > br$.
6. The firm has perpetual life.
7. Corporate taxes do not exist.

According to Gordon, the market value of a share is equal to the present value of future stream of dividends. Thus,

$$P = \frac{D}{k_e - br}$$

Where,

P = Price of shares

k_e = Cost of equity capital

$br = g$ = growth rate in r , i.e., rate of return on investment of an all-equity firm

D = Dividend per share or $(E(1-b))$

E = Earnings per share

b = Retention Ratio

The implications of Gordon's basic valuation model may be summarized as below:

1. When the rate of return of firm's investment is greater than the required rate of return, i.e. when $r > k$, the price per share increases as the dividend payout ratio decreases.



Thus, growth firm should distribute smaller dividends and should retain maximum earnings.

2. When the rate of return is equal to the required rate of return, i.e., when $r = k$, the price per share remains unchanged and is not affected by dividend policy. Thus, for a normal firm there is no optimum dividend payout.

3. When the rate of return is less than the required rate of return, i.e., when $r < k$, the price per share increases as the dividend payout ratio increases. Thus, the shareholders of declining firm stand to gain if the firm distributes its earnings. For such firms, the optimum pay out would be 100%.

MODIGLIANI-MILLER'S MODEL (M-M'S MODEL):

Modigliani-Miller's (M-M's) thoughts for irrelevance of dividends are most comprehensive and logical. According to them, dividend policy does not affect the value of a firm and is therefore, of no consequence. It is the earning potentiality and investment policy of the firm rather than its pattern of distribution of earnings that affects value of the firm.

Basic Assumptions of M-M Approach

- (1) There exists perfect capital market where all investors are rational. Information is available to all at no cost; there are no transaction costs and floatation costs. There is no such investor as could alone influence market value of shares.
- (2) There does not exist taxes. Alternatively, there is no tax differential between income on dividend and capital gains.
- (3) Firm has uncertainty as to future investments and profits of the firm. Thus, investors are able to predict future prices and dividend with certainty. This assumption is dropped by M-M later.

M-M's irrelevance approach is based on arbitrage argument. Arbitrage is the process of entering into such transactions simultaneously as exactly balance or completely offset each other. The two transactions in the present case are payment of dividends and

garnering funds to exploit investment opportunities. Suppose, for example, a firm decides to invest in a project it has alternatives:

- (1) Pay out dividends and raise an equal amount of funds from the market;
- (2) Retain its entire earnings to finance the investment programme. The arbitrage process is involved where a firm decides to pay dividends and raise funds from outside.

When a firm pays its earnings as dividends, it will have to approach market for procuring funds to meet a given investment programme. Acquisition of additional capital will dilute the firm's share capital which will result in drop in share values. Thus, what the stockholders gain in cash dividends they lose in decreased share values. The market price before and after payment of dividend would be identical and hence the stockholders would be indifferent between dividend and retention of earnings. This suggests that dividend decision is irrelevant. M-M's argument of irrelevance of dividend remains unchanged whether external funds are obtained by means of share capital or borrowings. This is for the fact that investors are indifferent between debt and equity with respect to leverage and cost of debt is the same as the real cost of equity. Finally, even under conditions of uncertainty, dividend decision will be of no relevance because of operation of arbitrage. Market value of share of the two firms would be the same if they are identical with respect to business risk, prospective future earnings and investment policies. This is because of rational behaviour of investor who would prefer more wealth to less wealth. Difference in respect of current and future dividend policies cannot influence share values of the two firms.

M-M approach contains the following mathematical formulations to prove irrelevance of dividend decision.

The market value of a share in the beginning of the year is equal to the present value of dividends paid at the year end plus the market price of the share at the end of the year, this can be expressed as below :

$$P_0 = \frac{P_1 + D_1}{1 + K} \dots\dots\dots \text{Equation (1)}$$

Where,

P_0 = Existing price of a share

K = Cost of capital

D_1 = Dividend to be received at the year end

P_1 = Market value of a share at the year end

If there is no additional financing from external sources, value of the firm (V) will be number of share (n) multiplied by the price of each share (P_0). Symbolically :

$$V = nP_0 = \frac{n(D_1 + P_1)}{1 + K} \dots\dots\dots \text{Equation (2)}$$

If the firm issues m number of share to raise funds at the end of year 1 so as to finance investment and at price P_1 , value of the firm at time 0 will be :

$$V = nP_0 = \frac{nD_1 + (n - m)P_1 - mP_1}{1 + K} \dots\dots\dots \text{Equation (3)}$$



Thus, the total value of the firm as per equation (3) is equal to the capitalized value of the dividends to be received during the period, plus the value of the number of share outstanding at the end of the period, less the value of the newly issued shares.

A firm can finance its investment programme either by ploughing back of its earnings or by issue of new share or by both. Thus, total amount of new share that the firm will issue to finance its investment will be :

$$\begin{aligned} mP_1 &= I_1 - (X_1 \cdot nD_1) \\ &= I_1 - X_1 + nD_1 \dots\dots\dots \text{Equation (4)} \end{aligned}$$

Where,

mP_1 = Total amount of funds raised by issue of new share to finance investment projects.

I_1 = Total amount of investment during first period X_1 = Total amount of net profit during first period

If equation (4) substituted into equation (3), we find the following equation :

$$nP_0 = \frac{(n+m)P_1 - I_1 + X_1}{1+K} \dots\dots\dots \text{Equation (5)}$$

On comparison of equation (5) with equation (3) we find that there is no difference between the two valuation equations although equation (5) has expressed the value of firm without dividends. This led M-M to conclude that dividend policy has no role to play in influencing share value of a firm

Criticism of MM Approach

MM hypothesis has been criticised on account of various unrealistic assumptions as given below.

1. Perfect capital market does not exist in reality.
2. Information about the company is not available to all the persons.
3. The firms have to incur flotation costs while issuing securities.
4. Taxes do exist and there is normally different tax treatment for dividends and capital gain.
5. The firms do not follow a rigid investment policy.
6. The investors have to pay brokerage, fees etc., while doing any transaction.
7. Shareholders may prefer current income as compared to further gains.

Therefore, whether dividends are paid or not, value of the firm remains the same as per M.M. approach

TYPES OF DIVIDENDS

Dividends may be declared in the form of cash, stock, scripts, bonds and property.

1. Cash Dividends

Cash dividend is, by far, the most important form of dividend. In cash dividends stockholders receive cheques for the amounts due to them. Cash generated by business earnings is used to pay cash dividends. Sometimes the firm may issue additional stock to use the proceeds so derived to pay cash dividends or approach bank for the purpose. Generally, stockholders have strong preference for cash dividends.

2. Stock Dividends

Stock dividends rank next to cash dividends in respect of their popularity. In this form of dividends, the firm issues additional shares of its own stock to the stockholders in proportion to the number of shares held in lieu of cash dividends. The payment of stock dividends neither affects cash and earnings position of the firm nor is ownership of stockholders changed. Indeed there will be transfer of the amount of dividend from surplus account to the capital stock account which tantamount to capitalization of retained earnings. The net effect of this would be an increase in number of shares of the current stockholders. But there will be no change in their equity. With payment of stock dividends the stockholders have simply more shares of stock to represent the same interest as it was before issuing stock dividends. Thus, there will be merely an adjustment in the firm's capital structure in terms of both book value and market price of the common stock.

2. Stock Splits

Closely related to a stock dividend is a stock split. From a purely economic point of view a stock split is nothing but a giant stock dividend. A stock split is a change in the number of outstanding shares of stock achieved through a proportional reduction of increase in the par value of the stock. The management employs this device to make a major adjustment in the market price of the firm's stock and consequently in its earnings and dividends per share. In stock split only the par value and number of outstanding shares are affected. The amounts in the common stock, premium and retained earnings remain unchanged. This is exhibited in the table. It may be noted from the table that although

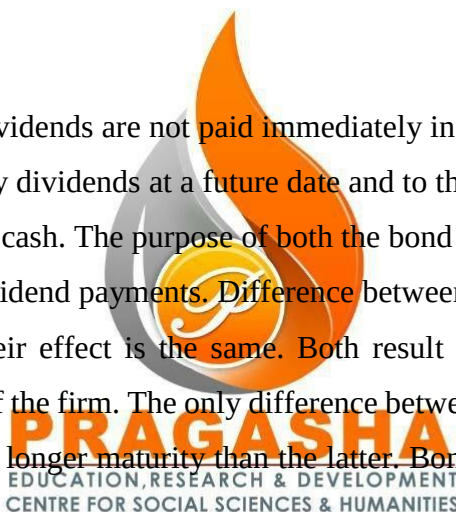
number of shares was doubled, capital account of the firm did not change because of proportional reduction in par value of the stock.

3. Scrip Dividend

Scrip dividend means payment of dividend in scrip or promissory notes. Sometimes company needs cash generated by business earnings to meet business requirements because of temporary shortage of cash. In such cases the company may issue scrip or notes promising to pay dividend at a future date. The scrip usually bears a definite date of maturity or sometimes maturity date is not stipulated and its payment is left to the discretion of the Board of Directors. Scrips may be interest-bearing or non-interest bearing. Such dividends are relatively scarce.

4. Bond Dividend

As in scrip dividends, dividends are not paid immediately in bond dividends. Instead the company promises to pay dividends at a future date and to that effect bonds are issued to stock holders in place of cash. The purpose of both the bond and scrip dividends is alike, i.e., postponement of dividend payments. Difference between the two is in respect of the date of payment and their effect is the same. Both result in lessening of surplus and addition to the liability of the firm. The only difference between bond and scrip dividends is that the former carries longer maturity than the latter. Bond dividends are not popular in India.



(5)Property Dividends

In property dividend the company pays dividends in the form of assets other than cash. Generally, assets which are superfluous for the company are distributed as dividends to the stockholders. Sometimes the company may use its products to pay dividends. Securities of the subsidiary companies owned by the company may also take the form of property dividends. This kind of dividend payment is not in vogue in India.

FACTORS AFFECTING DIVIDEND POLICY:

There is a controversy amongst financial analysts regarding impact of dividends on market price of a company's shares. Some argue that dividends do not have any impact

on such price while others hold a different opinion. However, preponderance of evidence suggests that dividend policies do have a significant effect on the value of the firm's equity shares in the stock exchange. Having accepted this premise, it will now be appropriate to consider those factors which affect the dividend policy of a firm.

The factors affecting the dividend policy are both external as well as internal.

External factors

1. General state of economy - The general state of economy affects to a great extent the management's decision to retain or distribute earnings of the firm. In case of uncertain economic and business conditions, the management may like to retain the whole or a part of the firm's earnings to build up reserves to absorb shocks in the future. Similarly in periods of depression, the management may also withhold-dividends payment to retain a large part of its earnings to preserve the firm's liquidity position. In periods of prosperity the management may not be liberal in dividend payments though the earning power of a company warrants it because of availability of larger profitable investment opportunities similarly in periods of inflation, the management may withhold dividend payments in order to retain larger proportion of the earnings for replacement of worn-out assets.

2. Legal restrictions - A firm may also be legally restricted from declaring and paying dividends. For example, in India, the companies Act, 1956 has put several restrictions regarding payments and declaration of dividends. Some of these restrictions are as follows :

- (i) Dividends can only be paid out of (a) the current profits of the company, (b) the past accumulated profits or (c) money provided by the Central or State Governments for the payment of dividends in pursuance of the guarantee given by the Government. Payment of dividend out of capital is illegal.
- (ii) A company is not entitled to pay dividends unless (a) it has provided for present as well as all arrears of depreciation, (b) a certain percentage of net profits of that year as prescribed by the central Government not exceeding 10%, has been transferred to the reserves of the company.
- (iii) Past accumulated profits can be used for declaration of dividends only as per the rules framed by the Central Government in this behalf.

Similarly, the Indian Income Tax Act also lays down certain restrictions on payment of dividends. The management has to take into consideration all the legal restrictions before taking the dividend decision otherwise it may be declared as ultra vires.

Internal factors

The following are the internal factors which affect the dividend policy of a firm:

1. Desire of the shareholders - Of course, the directors have considerable liberty regarding the disposal of the firm's earnings, but the shareholders are technically the owners of the company and, therefore, their desire cannot be overlooked by the directors while deciding about the dividend policy.

Shareholders of a firm expect two forms of return from their investment in a firm:

- (i) Capital gains - The shareholders expect an increase in the market value of the equity shares held by them over a period of time. Capital gain refers to the profit resulting from the sale of capital investment i.e., the equity shares in case of shareholders. For example, if a shareholder purchases a share for ₹ 40 and later on sells it for ₹ 60 the amount of capital gain is a sum of ₹ 20.
 - (ii) Dividends - The shareholders also expect a regular return on their investment from the firm. In most cases the shareholders' desire to get dividends takes priority over the desire to earn capital gains because of the following reasons:
 - (a) Reduction of uncertainty - Capital gains or a future distribution of earnings involves more uncertainty than a distribution of current earnings.
 - (b) Indication of strength - The declaration and payment of cash dividend carries an information content that the firm is reasonably strong and healthy.
 - (c) Need for current income - Many shareholders require income from the investment to pay for their current living expenses. Such shareholders are generally reluctant to sell their shares to earn capital gain.
2. Financial needs of the company - The financial needs of the company are to be considered by the management while taking the dividend decision. Of course, the financial needs of the company may be in direct conflict with the desire of the shareholders to receive large dividends. However, a prudent management should

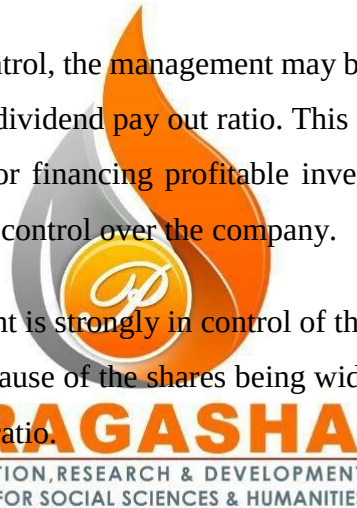
give more weightage to the financial needs of the company rather than the desire of the shareholders. In order to maximize the shareholders' wealth, it is advisable to retain earnings in the business only when company has better profitable investment opportunities as compared to the shareholders. However, the directors must retain some earnings, whether or not profitable investment opportunity exists, to maintain the company as a sound and solvent enterprise.

3. Desire of control - Dividend policy is also influenced by the desire of shareholders or the management to retain control over the company. The issue of additional equity shares for procuring funds dilutes control to the detriment of the existing equity shareholders who have a dominating voice in the company. At the same time, recourse to long-term loans may entail financial risks and may prove disastrous to the interests of the shareholders in times of financial difficulties.

In case of a strong desire for control, the management may be reluctant to pay substantial dividends and prefer a smaller dividend payout ratio. This is particularly true in case of companies which need funds for financing profitable investment opportunities and an outside group is seeking to gain control over the company.

However, where the management is strongly in control of the company either because of substantial shareholdings or because of the shares being widely held, the firm can afford to have a high dividend payout ratio.

1. Liquidity position - The payment of dividends results in cash outflow from the firm. A firm may have adequate earnings but it may not have sufficient cash to pay dividends. It is, therefore, important for the management to take into account the cash position and the overall liquidity position of the firm before and after payment of dividends while taking the dividend decision. A firm may not, therefore, be in a position to pay dividends in cash or at a higher rate because of insufficient cash resources. Such a problem is generally faced by growing firms which need constant funds for financing their expansion activities.



TYPES OF DIVIDEND POLICY:

The various types of dividend policies are discussed as follows:

1. Regular Dividend Policy

Payment of dividend at the usual rate is termed as regular dividend. The investors such as retired persons, widows and other economically weaker persons prefer to get regular dividends.

A regular dividend policy offers the following advantages.

- It establishes a profitable record of the company.
- It creates confidence amongst the shareholders.
- It aids in long-term financing and renders financing easier.
- It stabilizes the market value of shares.
- The ordinary shareholders view dividends as a source of funds to meet their day-to-day living expenses.
- If profits are not distributed regularly and are retained, the shareholders may have to pay a higher rate of tax in the year when accumulated profits are distributed.

However, it must be remembered that regular dividends can be maintained only by companies of long standing and stable earnings. A company should establish the regular dividend at a lower rate as compared to the average earnings of the company.

2. Stable Dividend Policy

The term 'stability of dividends' means consistency or lack of variability in the stream of dividend payments. In more precise terms, it means payment of certain minimum amount of dividend regularly. A stable dividend policy may be established in any of the following three forms.

Constant dividend per share: Some companies follow a policy of paying fixed dividend per share irrespective of the level of earnings year after year. Such firms, usually, create a 'Reserve for Dividend Equalisation' to enable them to pay the fixed dividend even in the year when the earnings are not sufficient or when there are losses. A policy of constant

dividend per share is most suitable to concerns whose earnings are expected to remain stable over a number of years. Figure given below shows the behaviour of dividend in such policy.

2. Irregular Dividend Policy

Some companies follow irregular dividend payments on account of the following:

- Uncertainty of earnings.
- Unsuccessful business operations.
- Lack of liquid resources.
- Fear of adverse effects of regular dividends on the financial standing of the company.

4. No Dividend Policy

A company may follow a policy of paying no dividends presently because of its unfavourable working capital position or on account of requirements of funds for future expansion and growth.

5. Residual Dividend Policy

When new equity is raised floatation costs are involved. This makes new equity costlier than retained earnings. Under the Residual approach, dividends are paid out of profits after making provision for money required to meet upcoming capital expenditure commitments

WORKING CAPITAL MANAGEMENT

The term working capital is commonly used for the capital required for day-to-day working in a business concern, such as for purchasing raw material, for meeting day-to-day expenditure on salaries, wages, rents rates, advertising etc. But there are much disagreement among various financial authorities (Financiers, accountants, businessmen and economists) as to the exact meaning of the term working capital.

DEFINITION AND CLASSIFICATION OF WORKING CAPITAL :

Working capital refers to the circulating capital required to meet the day to day operations of a business firm. Working capital may be defined by various authors as follows:

1. According to Weston & Brigham - “Working capital refers to a firm’s investment in short term assets, such as cash amounts receivables, inventories etc.
2. Working capital means current assets. —Mead, Baker and Malott
3. “The sum of the current assets is the working capital of the business” —J.S.Mill
Working capital is defined as “the excess of current assets over current liabilities and provisions”.

But as per accounting terminology, it is difference between the inflow and outflow of funds. In the Annual Survey of Industries (1961), working capital is defined to include “Stocks of materials, fuels, semi-finished goods including work-in-progress and finished goods and by-products; cash in hand and bank and the algebraic sum of sundry creditors as represented by (a) outstanding factory payments e.g. rent, wages, interest and dividend; b) purchase of goods and services; c) short-term loans and advances and sundry debtors comprising amounts due to the factory on account of sale of goods and services and advances towards tax payments”.

The term “working capital” is often referred to “circulating capital” which is frequently used to denote those assets which are changed with relative speed from one form to another i.e., starting from cash, changing to raw materials, converting into work-in-progress and finished products, sale of finished products and ending with realization of cash from debtors. Working capital has been described as the “life blood of any business which is apt because it constitutes a cyclically flowing stream through the business”.

Concepts of working capital

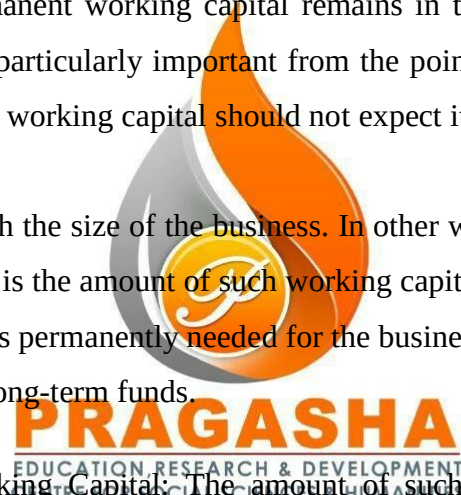
1. Gross Working Capital: It refers to the firm’s investment in total current or circulating assets.
2. Net Working Capital: The term “Net Working Capital” has been defined in two different ways:
 - i. It is the excess of current assets over current liabilities. This is, as a matter of fact, the most commonly accepted definition. Some people define it as only the difference between

current assets and current liabilities. The former seems to be a better definition as compared to the latter.

ii. It is that portion of a firm's current assets which is financed by long-term funds.

3. **Permanent Working Capital:** This refers to that minimum amount of investment in all current assets which is required at all times to carry out minimum level of business activities. In other words, it represents the current assets required on a continuing basis over the entire year. Tandon Committee has referred to this type of working capital as "Core current assets".

The following are the characteristics of this type of working capital:

1. Amount of permanent working capital remains in the business in one form or another. This is particularly important from the point of view of financing. The suppliers of such working capital should not expect its return during the life-time of the firm.
 2. It also grows with the size of the business. In other words, greater the size of the business, greater is the amount of such working capital and vice versa Permanent working capital is permanently needed for the business and therefore it should be financed out of long-term funds.
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1. **Temporary Working Capital:** The amount of such working capital keeps on fluctuating from time to time on the basis of business activities. In other words, it represents additional current assets required at different times during the operating year. For example, extra inventory has to be maintained to support sales during peak sales period. Similarly, receivable also increase and must be financed during period of high sales. On the other hand investment in inventories, receivables, etc., will decrease in periods of depression. Suppliers of temporary working capital can expect its return during off season when it is not required by the firm. Hence, temporary working capital is generally financed from short-term sources of finance such as bank credit.
 2. **Negative Working Capital:** This situation occurs when the current liabilities exceed the current assets. It is an indication of crisis to the firm.

Need for Working Capital

Working capital is needed till a firm gets cash on sale of finished products. It depends on two factors:

i. Manufacturing cycle i.e. time required for converting the raw material into finished product; and ii. Credit policy i.e. credit period given to Customers and credit period allowed by creditors.

Thus, the sum total of these times is called an “Operating cycle” and it consists of the following six steps:

- Conversion of cash into raw materials.
- Conversion of raw materials into work-in-process.
- Conversion of work-in-process into finished products.
- Time for sale of finished goods—cash sales and credit sales.
- Time for realisation from debtors and Bills receivables into cash.
- Credit period allowed by creditors for credit purchase of raw materials, inventory and creditors for wages and overheads.

DETERMINANTS OF WORKING CAPITAL:



The factors influencing the working capital decisions of a firm may be classified as two groups, such as internal factors and external factors. The internal factors includes, nature of business size of business, firm's product policy, credit policy, dividend policy, and access to money and capital markets, growth and expansion of business etc. The external factors include business fluctuations, changes in the technology, infrastructural facilities, import policy and the taxation policy etc. These factors are discussed in brief in the following lines.

I. Internal Factors

1. Nature and size of the business

The working capital requirements of a firm are basically influenced by the nature and size of the business. Size may be measured in terms of the scale of operations. A firm with

larger scale of operations will need more working capital than a small firm. Similarly, the nature of the business - influence the working capital decisions. Trading and financial firms have less investment in fixed assets. But require a large sum of money to be invested in working capital. Retail stores, business units require larger amount of working capital, where as, public utilities need less working capital and more funds to invest in fixed assets.

2. Firm's production policy

The firm's production policy (manufacturing cycle) is an important factor to decide the working capital requirement of a firm. The production cycle starts with the purchase and use of raw material and completes with the production of finished goods. On the other hand production policy is uniform production policy or seasonal production policy etc., also influences the working capital decisions. Larger the manufacturing cycle and uniform production policy –larger will be the requirement of working capital. The working capital requirement will be higher with varying production schedules in accordance with the changing demand.

3. Firm's credit policy

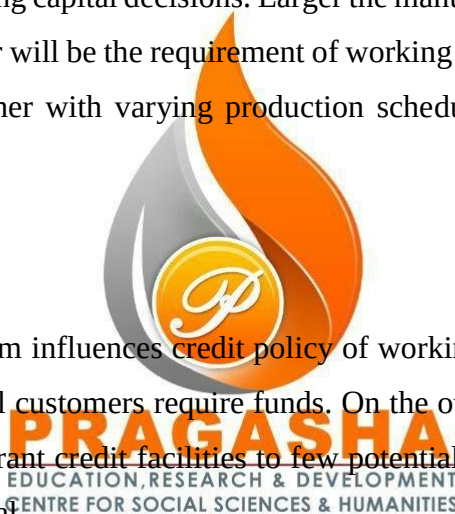
The credit policy of a firm influences credit policy of working capital. A firm following liberal credit policy to all customers require funds. On the other hand, the firm adopting strict credit policy and grant credit facilities to few potential customers will require less amount of working capital.

4. Availability of credit

The working capital requirements of a firm are also affected by credit terms granted by its suppliers – i.e. creditors. A firm will need less working capital if liberal credit terms are available to it. Similarly, the availability of credit from banks also influences the working capital needs of the firm. A firm, which can get bank credit easily on favourable conditions, will be operated with less working capital than a firm without such a facility.

5. Growth and expansion of business

Working capital requirement of a business firm tend to increase in correspondence with growth in sales volume and fixed assets. A growing firm may need funds to invest in fixed



assets in order to sustain its growing production and sales. This will, in turn, increase investment in current assets to support increased scale of operations. Thus, a growing firm needs additional funds continuously.

6. Profit margin and dividend policy

The magnitude of working capital in a firm is dependent upon its profit margin and dividend policy. A high net profit margin contributes towards the working capital pool. To the extent the net profit has been earned in cash, it becomes a source of working capital. This depends upon the dividend policy of the firm. Distribution of high proportion of profits in the form of cash dividends results in a drain on cash resources and thus reduces company's working capital to that extent. The working capital position of the firm is strengthened if the management follows conservative dividend policy and vice versa.

7. Operating efficiency of the firm

Operating efficiency means the optimum utilisation of a firm's resources at minimum cost. If a firm successfully controls operating cost, it will be able to improve net profit margin which, will, in turn, release greater funds for working capital purposes.

8. Co-ordinating activities in firm

The working capital requirements of a firm is depend upon the co-ordination between production and distribution activities. The greater and effective the co-ordinations, the pressure on the working capital will be minimized. In the absence of co-ordination, demand for working capital is reduced.

II. External Factors

1. Business fluctuations

Most firms experience fluctuations in demand for their products and services. These business variations affect the working capital requirements. When there is an upward swing in the economy, sales will increase, correspondingly, the firm's investment in inventories and book debts will also increase. Under boom, additional investment in fixed assets may be made by some firms to increase their productive capacity. This act of the firm will require additional funds. On the other hand when, there is a decline in economy,

sales will come down and consequently the conditions, the firm try to reduce their short-term borrowings. Similarly the seasonal fluctuations may also affect the requirement of working capital of a firm.

2. Changes in the technology

The technological changes and developments in the area of production can have immediate effects on the need for working capital. If the firm wish to install a new machine in the place of old system, the new system can utilise less expensive raw materials, the inventory needs may be reduced there by working capital needs.

3. Import policy

Import policy of the Government may also effect the levels of working capital of a firm since they have to arrange funds for importing goods at specified times.

4. Infrastructural facilities

The firms may require additional funds to maintain the levels of inventory and other current assets, when there is good infrastructural facilities in the company like, transportation and communications.

5. Taxation policy



The tax policies of the Government will influence the working capital decisions. If the Government follow regressive taxation policy, i.e. imposing heavy tax burdens on business firms, they are left with very little profits for distribution and retention purpose. Consequently the firm has to borrow additional funds to meet their increased working capital needs. When there is a liberalised tax policy, the pressure on working capital requirement is minimised. Thus the working capital requirements of a firm is influenced by the internal and external factors.

MEASUREMENT OF WORKING CAPITAL:

There are 3 methods for assessing the working capital requirement as explained below:

a) Percent of Sales Method

Based on the past experience, some percentage of sales may be taken for determining the quantum of working capital

b) Regression Analysis Method

The relationship between sales and working capital and its various components may be plotted on Scatter diagram and the average percentage of past 5 years may be ascertained. This average percentage of sales may be taken as working capital. Similar exercise may be carried out at the beginning of the year for assessing the working capital requirement. This method is suitable for simple as well as complex situations.

c) Operating Cycle Method:

It is also known as working capital cycle. Operating cycle is the total time gap between the purchase of raw material and the receipt from Debtors.

The working capital estimation as per the method of operating cycle, is the most systematic and logical approach. In this case, the working capital estimation is made on the basis of analysis of each and every component of the working capital individually. As already discussed the working capital, required to sustain the level of planned operations, is determined by calculating all the individual components of current assets and current liabilities.

The calculation of net working capital may also be shown as follows ;

Working Capital = Current Assets – Current Liabilities

(Raw Materials Stock + Work-in-progress Stock + Finished Goods Stock + Debtors + Cash Balance) – (Creditors + Outstanding Wages + Outstanding Overheads).

Where,

Raw Materials = Cost (Average) of Materials in Stock
Work-in-progress Stock = Cost of Materials + Wages + Overhead of Work-in-progress
Finished Goods Stock = Cost of

Materials + Wages + Overhead of Finished Goods. Creditors for Material = Cost of Average Outstanding Creditors. Creditors for Wages = Averages Wages Outstanding.

Creditors for Overhead = Average Overheads Outstanding.

Thus, Working Capital = Cost of Materials in Stores, in Work-in-progress, in Finished Goods and in Debtors.

Less : Creditors for Materials

Plus : Wages in Work-in-progress, in Finished Goods and in Debtors.

Less : Creditors for Wages.

Plus : Overheads in Work-in-progress, in Finished Goods and in Debtors.

Less : Creditors for Overheads.

The work sheet for estimation of working capital requirements under the operating cycle method may be presented as follows :

Estimation of Working Capital Requirements

The following points are also worth noting while estimating the working capital requirement :



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Estimation of Working Capital Requirements

I Current Assets :	Amount	Amount	Amount
Minimum Cash Balance		****	
Inventories :			
Raw Materials	****		
Work-in-progress	****		
Finished Goods	****	****	
Receivables :			
Debtors	****		
Bills	****	****	
Gross Working Capital (CA)		****	****
II Current Liabilities :			
Creditors for Purchases		****	
Creditors for Wages		****	
Creditors for Overheads		****	****
Total Current Liabilities (CL)		****	****
Excess of CA over CL			****
+ Safety Margin			****
Net Working Capital			****

1. **Depreciation:** An important point worth noting while estimating the working capital requirement is the depreciation on fixed assets. The depreciation on the fixed assets, which are used in the production process or other activities, is not considered in working capital estimation. The depreciation is a non-cash expense and there is no funds locked up in depreciation as such and therefore, it is ignored. Depreciation is neither included in valuation of work-in-progress nor in finished goods. The working capital calculated by ignoring depreciation is known as cash basis working capital. In case, depreciation is included in working capital calculations, such estimate is known as total basis Working capital.
2. **Safety Margin:** Sometimes, a firm may also like to have a safety margin of working capital in order to meet any contingency. The safety margin may be expressed as a % of total current assets or total current liabilities or net working capital. The safety margin, if required, is incorporated in the working capital estimates to find out the net working capital required for the firm. There is no hard

and fast rule about the quantum of safety margin and depends upon the nature and characteristics of the firm as well as of its current assets and current liabilities.

Importance or Advantages of Adequate Working Capital

Working capital is the life blood and nerve centre of a business. Just as circulation of blood is essential in the human body for maintaining life, working capital is very essential to maintain the smooth running of a business. No business can run successfully without an adequate amount of working capital. The main advantages of maintaining adequate amount of working capital are as follows:

1. **Solvency of the business:** Adequate working capital helps in maintaining solvency of the business by providing uninterrupted flow of production.
2. **Goodwill:** Sufficient working capital enables a business concern to make prompt payments and hence helps in creating and maintaining goodwill.
3. **Easy loans:** A concern having adequate working capital, high solvency and good credit standing can arrange loans from banks and other on easy and favourable terms.
4. **Cash discounts:** Adequate working capital also enables a concern to avail cash discounts on the purchases and hence it reduces costs.
5. **Regular supply of raw materials:** Sufficient working capital ensures regular supply of raw materials and continuous production.
6. **Regular payment of salaries, wages and other day-to-day commitments :** A company which has ample working capital can make regular payment of salaries, wages and other day-to-day commitments which raises the morale of its employees, increases their efficiency, reduces wastages and costs and enhances production and profits
7. **Exploitation of favourable market conditions:** Only concerns with adequate working capital can exploit favourable market conditions such as purchasing its requirements in bulk when the prices are lower and by holding its inventories for higher prices.
8. **Ability to face crisis:** Adequate working capital enables a concern to face business crisis in emergencies such as depression because during such periods, generally, there's much pressure on working capital.
9. **Quick and regular return on investments:** Every Investor wants a quick and regular return on his investments. Sufficiency of working capital enables a concern to pay quick and regular dividends to its investors as there may not be much pressure to

plough back profits. This gains the confidence of its investors and creates a favourably market to raise additional funds i.e., the future.

10. High morale: Adequacy of working capital creates an environment of security, confidence, high morale and creates overall efficiency in a business.

Excess or Inadequate Working Capital

Every business concern should have adequate working capital to run its business operations. It should have neither redundant or excess working capital nor inadequate or shortage of working capital. Both excess as well as short working capital positions are bad for any business. However, out of the two, it is the inadequacy of working capital which is more dangerous from the point of view of the firm.

Disadvantages of Redundant or Excessive Working Capital

1. Excessive Working Capital means idle funds which earn no profits for the business and hence the business cannot earn a proper rate of return on its investments.
2. When there is a redundant working capital, it may lead to unnecessary purchasing and accumulation of inventories causing more chances of theft, waste and losses
3. Excessive working capital implies excessive debtors and defective credit policy which may cause higher incidence of bad debts.
4. It may result into overall inefficiency in the organization.
5. When there is excessive working capital, relations with banks and other financial institutions may not be maintained.
6. Due to low rate of return on investments, the value of shares may also fall.

7. The redundant working capital gives rise to speculative transactions

Disadvantages or Dangers of Inadequate Working Capital

1. A concern which has inadequate working capital cannot pay its short-term liabilities in time. Thus, it will lose its reputation and shall not be able to get good credit facilities.
2. It cannot buy its requirements in bulk and cannot avail of discounts, etc.
3. It becomes difficult for the firm to exploit favourable market conditions and undertake profitable projects due to lack of working capital.

4. The firm cannot pay day-to-day expenses of its operations and it creates inefficiencies, increases costs and reduces the profits of the business.
5. It becomes impossible to utilize efficiently the fixed assets due to non-availability of liquid funds.
6. The rate of return on investments also falls with the shortage of working capital.

WORKING CAPITAL FINANCING:

Accruals

The major accrual items are wages and taxes. These are simply what the firm owes to its employees and to the government.

Trade Credit

Trade credit represents the credit extended by the supplier of goods and services. It is a spontaneous source of finance in the sense that it arises in the normal transactions of the firm without specific negotiations, provided the firm is considered creditworthy by its supplier. It is an important source of finance representing 25% to 50% of short-term financing.

Working Capital Advance by Commercial Banks

Working capital advance by commercial banks represents the most important source for financing current assets.

Short-term Loans from Financial Institutions

The Life Insurance Corporation of India and the General Insurance Corporation of India provide short-term loans to manufacturing companies with an excellent track record.

Rights Debentures for Working Capital

Public limited companies can issue “Rights” debentures to their shareholders with the object of augmenting the long-term resources of the company for working capital requirements.



The key guidelines applicable to such debentures are as follows:

- i. The amount of the debenture issue should not exceed (a) 20% of the gross current assets, loans, and advances minus the long-term funds presently available for financing working capital, or (b) 20% of the paid-up share capital, including preference capital and free reserves, whichever is the lower of the two.
- ii. The debt. -equity ratio, including the proposed debenture issue, should not exceed 1:1.
- iii. The debentures shall first be offered to the existing Indian resident shareholders of the company on a pro rata basis.

Commercial Paper

Commercial paper represents short-term unsecured promissory notes issued by firms which enjoy a fairly high credit rating. Generally, large firms with considerable financial strength are able to issue commercial paper. The important features of commercial paper are as follows:

- i. The maturity period of commercial paper usually ranges from 90 days to 360 days.
- ii. Commercial paper is sold at a discount from its face value and redeemed at its face value. Hence the implicit interest rate is a function of the size of the discount and the period of maturity.

Commercial paper is directly placed with investors who intend holding it till its maturity. Hence there is no well developed secondary market for commercial paper.

Factoring

Factoring, as a fund based financial service, provides resources to finance receivables as well as facilitates the collection of receivables. It is another method of raising short-term finance through account receivable credit offered by commercial banks and factors. A commercial bank may provide finance by discounting the bills or invoices of its customers. Thus, a firm gets immediate payment for sales made on credit. A factor is a financial institution which offers services relating to management and financing of debts arising out of credit sales. Factoring is becoming popular all over the world on account of various services offered by the institutions engaged in it. Factors render services varying from bill discounting facilities offered by commercial banks to a total take over of

administration of credit sales including maintenance of sales ledger, collection of accounts receivables, credit control and protection from bad debts, provision of finance and rendering of advisory services to their clients. Factoring may be on a recourse basis, where the risk of bad debts is borne by the client, or on a non-recourse basis, where the risk of credit is borne by the factor.

MANAGEMENT OF WORKING CAPITAL:

Working Capital Management involves management of different components of working capital such as cash, inventories, accounts receivable, creditors etc. A brief description follows regarding the various issues involved in the management of each of the above components of working capital.

INVENTORY MANAGEMENT:

Inventory constitutes an important item in the working capital of many business concerns. Net working capital is the difference between current assets and current liabilities. Inventory is a major item of current assets. The term inventory refers to the stocks of the product of a firm is offering for sale and the components that make up the product. Inventory is stores of goods and stocks. This includes raw materials, work-in-process and finished goods. Raw materials consist of those units or input which are used to manufacture goods that require further processing to become finished goods. Finished goods are products ready for sale. The classification of inventories and the levels of the components vary from organisation to organisation depending upon the nature of business. For example steel is a finished product for a steel industry, but raw material for an automobile manufacturer. Thus, inventory may be defined as “Stock of goods that is held for future use”. Since inventories constitute about 50 to 60 percent of current assets, the management of inventories is crucial to successful working capital management. Working capital requirements are influenced by inventory holding. Hence, the need for effective and efficient management of inventories. Inventory management refers to an optimum investment in inventories. It should neither be too low to effect the production adversely nor too high to block the funds unnecessarily. Excess investment in inventories is unprofitable for the business. Both excess and inadequate investment in inventories is not desirable. The firm should operate within the two danger points. The purpose of inventory management is to determine and maintain the optimum level of inventory investment.

Techniques of Inventory Control

The following are the various measures of selective control of inventory :

A. Economic Ordering Quantity (EOQ): It is important to note that only the correct quantity of materials is to be purchased. For this purpose, the factors such as maximum level, minimum level, danger level, re-ordering level, quantity already on order, quantity reserved, availability of funds, quantity discount, interest on capital, average consumption and availability of storage accommodation are to be kept in view. There should not be any over stock vis-à-vis no question of non-stock. Balance should be made between the cost of carrying and cost of non-carrying i.e. cost of stock-out. Cost of carrying includes the cost of storage, insurance, obsolescence, interest on capital invested. Cost of not carrying includes the costly purchase, loss of production and sales and loss of customer's goodwill. Economic Ordering Quantity (EOQ) is the quantity fixed at the point where the total cost of ordering and the cost of carrying the inventory will be the minimum. If the quantity of purchases is increased, the cost of ordering decreases while the cost of carrying increases. If the quantity of purchases is decreased, the cost of ordering increases while the cost of carrying decreases. But in this case, the total of both the costs should be kept at minimum. Thus, EOQ may be arrived at by Tabular method by preparing purchase order quantity tables showing the ordering cost, carrying cost and total cost of various sizes of purchase orders.



B. Fixing levels (Quantity Control) - For fixing the various levels such as maximum, minimum, etc., average consumption and lead time i.e. the average time taken between the initiation of purchase order and the receipt of materials from suppliers are to be estimated for each item of materials.

a. Maximum Stock Level - The maximum stock level is that quantity above which stocks should not normally be allowed to exceed. The following factors are taken into consideration while fixing the maximum stock level:

1. Average rate of consumption of material.
2. Lead time.
3. Re-order level.
4. Maximum requirement of materials for production at any time.

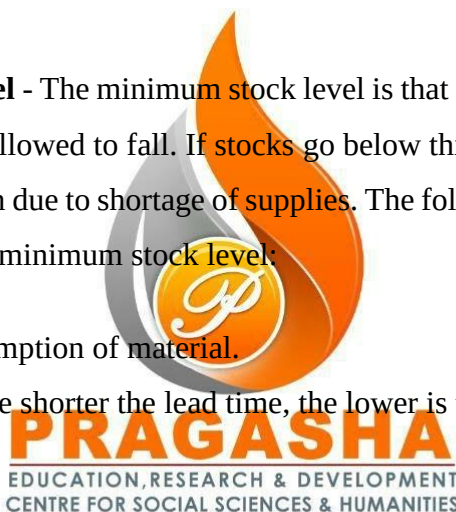
5. Storage space available cost of storage and insurance.
6. Financial consideration such as price fluctuations, availability of capital, discounts due to seasonal and bulk purchases, etc.
7. Keeping qualities e.g. risk of deterioration, obsolescence, evaporation, depletion and natural waste, etc.
8. Any restrictions imposed by local or national authority in regard to materials i.e. purchasing from small scale industries and public sector undertakings, price preference clauses, import policy, explosion in case of explosive materials, risk of fire, etc.; and

9. Economic ordering quantity is also considered. Formula

Maximum Level = Re-order level—(Minimum consumption) × (Minimum lead times)
+Reordering quantity

b. Minimum Stock Level - The minimum stock level is that quantity below which stocks should not normally be allowed to fall. If stocks go below this level, there will be danger of stoppage of production due to shortage of supplies. The following factors are taken into account while fixing the minimum stock level:

1. Average rate of consumption of material.
2. Average lead time. The shorter the lead time, the lower is the minimum level.
3. Re-order level.
4. Nature of the item.
5. Stock out cost.



Formula

Minimum Level = Re-order level – (Average usage × Average lead time)

c. Re - order Level - This is the point fixed between the maximum and minimum stock levels and at this time, it is essential to initiate purchase action for fresh supplies of the material. In order to cover the abnormal usage of material or unexpected delay in delivery of fresh supplies, this point will usually be fixed slightly higher than the minimum stock level. The following factors are taken into account while fixing the re-order level:

1. Maximum usage of materials
2. Maximum lead time
3. Maximum stock level
4. Minimum stock level Formula

Re-order level = Maximum usage X Maximum lead time or Minimum level + Consumption during lead time.

Re-ordering Quantity (How much to purchase): It is also called Economic Ordering Quantity.

d. Danger level.- This is the level below the minimum stock level. When the stock reaches this level, immediate action is needed for replenishment of stock. As the normal lead time is not available, regular purchase procedure cannot be adopted resulting in higher purchase cost. Hence, this level is useful for taking corrective action only. If this is fixed below the reorder level and above the minimum level, it will be possible to take preventive action.

C. ABC Analysis for Inventory Control: ABC analysis is a method of material control according to value. The basic principle is that high value items are more closely controlled than the low value items. The materials are grouped according to the value and frequency of replenishment during a Period.



‘A’ Class items: Small percentage of the total items but having higher values.

‘B’ Class items: More percentage of the total items but having medium values.

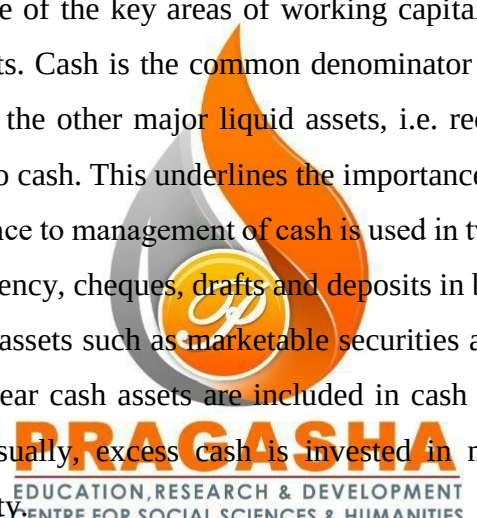
‘C’ Class items: High percentage of the total items but having low values.

D. V.E.D. Classification: The V.E.D. classification is applicable mainly to the spare parts. Spares are classified as vital (V), essential (E) and desirable (D). Vital class spares have to be stocked adequately to ensure the operations of the plant but some risk can be taken in the case of ‘E’ class spares. Stocking of desirable spares can even be done away with if the lead time for their procurement is low. Similarly, classification may be done in respect of the plant and machinery as vital, essential, important and normal (VEIN).

E. Just in Time (JIT): Normally, inventory costs are high and controlling inventory is complex because of uncertainties in supply, dispatching, transportation etc. Lack of coordination between suppliers and ordering firms is causing severe irregularities, ultimately the firm ends-up in inventory problems. Toyota Motors has first time suggested just – in – time approach in 1950s. This means the material will reach the points of production process directly from the suppliers as per the time schedule. It is possible in the case of companies with respective process. Since, it requires close coordination between suppliers and the ordering firms, and therefore, only units with systematic approach will be able to implement it.

CASH MANAGEMENT

Cash management is one of the key areas of working capital management. Cash is the most liquid current assets. Cash is the common denominator to which all current assets can be reduced because the other major liquid assets, i.e. receivable and inventory get eventually converted into cash. This underlines the importance of cash management. The term “Cash” with reference to management of cash is used in two ways. In a narrow sense cash refers to coins, currency, cheques, drafts and deposits in banks. The broader view of cash includes near cash assets such as marketable securities and time deposits in banks. The reason why these near cash assets are included in cash is that they can readily be converted into cash. Usually, excess cash is invested in marketable securities as it contributes to profitability.

The logo for Pragasha Education, Research & Development Centre for Social Sciences & Humanities is positioned in the center of the page. It features a stylized orange flame or drop shape above a yellow circle containing a white 'P'. Below this graphic, the word 'PRAGASHA' is written in large, bold, orange capital letters. Underneath 'PRAGASHA', the words 'EDUCATION, RESEARCH & DEVELOPMENT' are written in smaller, blue capital letters, and at the bottom, 'CENTRE FOR SOCIAL SCIENCES & HUMANITIES' is written in even smaller, blue capital letters.

Cash is one of the most important components of current assets. Every firm should have adequate cash, neither more nor less. Inadequate cash will lead to production interruptions, while excessive cash remains idle and will impair profitability. Hence, the need for cash management.

Thus, the aim of cash management is to maintain adequate cash balances at one hand and to use excess cash in some profitable way on the other hand.

Motives

Motives or desires for holding cash refer to various purposes. The purpose may be different from person to person and situation to situation. There are four important motives to hold cash.

a. Transactions motive - This motive refers to the holding of cash, to meet routine cash requirements in the ordinary course of business. A firm enters into a number of transactions which requires cash payment. For example, purchase of materials, payment of wages, salaries, taxes, interest etc. Similarly, a firm receives cash from cash sales, collections from debtors, return on investments etc. But the cash inflows and cash outflows do not perfectly synchronise. Sometimes, cash receipts are more than payments while at other times payments exceed receipts. The firm must have to maintain sufficient (funds) cash balance if the payments are more than receipts. Thus, the transactions motive refers to the holding of cash to meet expected obligations whose timing is not perfectly matched with cash receipts. Though, a large portion of cash held for transactions motive is in the form of cash, a part of it may be invested in marketable securities whose maturity conform to the timing of expected payments such as dividends, taxes etc.

b. Precautionary motive - Apart from the non-synchronisation of expected cash receipts and payments in the ordinary course of business, a firm may be failed to pay cash for unexpected contingencies. For example, strikes, sudden increase in cost of raw materials etc. Cash held to meet these unforeseen situations is known as precautionary cash balance and it provides a caution against them. The amount of cash balance under precautionary motive is influenced by two factors i.e. predictability of cash flows and the availability of short term credit. The more unpredictable the cash flows, the greater the need for such cash balances and vice versa. If the firm can borrow at short-notice, it will need a relatively small balance to meet contingencies and vice versa. Usually precautionary cash balances are invested in marketable securities so that they contribute something to profitability.

c. Speculative motive - Sometimes firms would like to hold cash in order to exploit, the profitable opportunities as and when they arise. This motive is called as speculative motive. For example, if the firm expects that the material prices will fall, it can delay the purchases and make purchases in future when price actually declines. Similarly, with the

hope of buying securities when the interest rate is expected to decline, the firm will hold cash. By and large, firms rarely hold cash for speculative purposes.

d. Compensation motive - This motive to hold cash balances is to compensate banks and other financial institutes for providing certain services and loans. Banks provide a variety of services to business firms like clearance of cheques, drafts, transfer of funds etc. Banks charge a commission or fee for their services to the customers as indirect compensation. Customers are required to maintain a minimum cash balance at the bank. This balance cannot be used for transaction purposes. Banks can utilise the balances to earn a return to compensate their cost of services to the customers. Such balances are compensating balances. These balances are also required by some loan agreements between a bank and its customers. Banks require a chest to maintain a minimum cash balance in his account to compensate the bank when the supply of credit is restricted and interest rates are rising. Thus cash is required to fulfil the above motives. Out of the four motives of holding cash balances, transaction motive and compensation motives are very important. Business firms usually do not speculate and need not have speculative balances. The requirement of precautionary balances can be met out of short-term borrowings.

MANAGEMENT OF RECEIVABLES

Receivables means the book debts or debtors and these arise, if the goods are sold on credit. Debtors form about 30% of current assets in India. Debt involves an element of risk and bad debts also. Hence, it calls for careful analysis and proper management. The goal of receivables management is to maximize the value of the firm by achieving a trade off between risk and profitability. For this purpose, a finance manager has:

1. to obtain optimum (non-maximum) value of sales;
2. to control the cost of receivables, cost of collection, administrative expenses, bad debts and opportunity cost of funds blocked in the receivables.
3. to maintain the debtors at minimum according to the credit policy offered to customers.
4. to offer cash discounts suitably depending on the cost of receivables, bank rate of interest and opportunity cost of funds blocked in the receivables.

Factors Affecting the Size of Receivables

The size of accounts receivable is determined by a number of factors. Some of the important factors are as follows

1. **Level of sales** - Generally in the same industry, a firm having a large volume of sales will be having a larger level of receivables as compared to a firm with a small volume of sales. Sales level can also be used for forecasting change in accounts receivable. For example, if a firm predicts that there will be an increase of 20% in its credit sales for the next period, it can be expected that there will also be a 20% increase in the level of receivables.
2. **Credit policies** - The term credit policy refers to those decision variables that influence the amount of trade credit, i.e., the investment in receivables. These variables include the quantity of trade accounts to be accepted, the length of the credit period to be extended, the cash discount to be given and any special terms to be offered depending upon particular circumstances of the firm and the customer.
3. **Terms of trade** - The size of the receivables is also affected by terms of trade (or credit terms) offered by the firm. The two important components of the credit terms are (i) Credit period and (ii) Cash discount.

Credit Policy

A firm should establish receivables policies after carefully considering both benefits and costs of different policies. These policies relate to.

- (i) Credit Standards, (ii) Credit Terms, and (iii) Collection Procedures.

i. Credit standards -

The term credit standards represent the basic criteria for extension of credit to customers. The levels of sales and receivables are likely to be high if the credit standards are relatively loose, as compared to a situation when they are relatively tight. The firm's credit standards are generally determined by the five "C's". Character, Capacity, Capital, Collateral and Conditions of customer.

ii. Credit terms

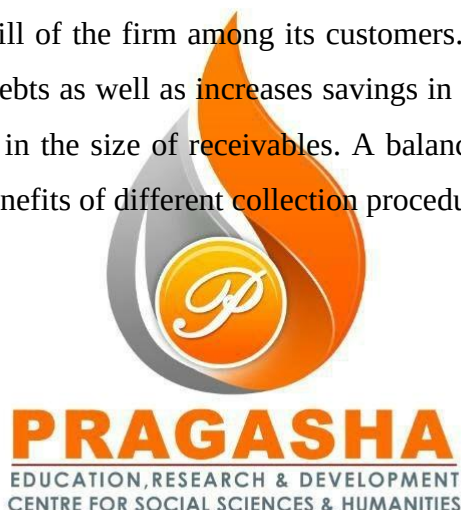
It refers to the terms under which a firm sells goods on credit to its customers. As stated earlier, the two components of the credit terms are (a) Credit Period and (b) Cash Discount.

(a) Credit period - Extending the credit period stimulates sales but increases the cost on account of more tying up of funds in receivables.

(b) Cash discount - The effect of allowing cash discount can also be analysed on the same pattern as that of the credit period. Attractive cash discount terms reduce the average collection period resulting in reduced investment in accounts receivable.

iii. Collection procedures

A stringent collection procedure is expensive for the firm because of high out-of-pocket costs and loss of goodwill of the firm among its customers. However, it minimises the loss on account of bad debts as well as increases savings in terms of lower capital costs on account of reduction in the size of receivables. A balance has therefore to be struck between the costs and benefits of different collection procedures or policies.



Unit – 8: Human Resource Management

- ✓ Concepts, Role and Function of Human Resource Management
- ✓ Human Resource Planning, Recruitment and Selection
- ✓ Job Analysis, Job Description and Specifications, Use of Job Analysis Information
- ✓ Training and Development, Succession Planning
- ✓ Compensation: Wage and Salary Administration, Incentive and Fringe Benefits, Morale and Productivity
- ✓ Performance Appraisal
- ✓ Industrial Relations in India, Health, Safety, Welfare and Social Security, Worker's Participation in Management

Human Resource Management

Concept And Meaning Of Human Resource Management (HRM)

Human resource management was previously known as personnel management which was concerned with the activities of a single department. It was typically concerned with the administration of human. The functions carried out by the department were **recruitment and selection**, reward, appraisal, development, grievance handling, retirement, registration and so forth. It was introduced and developed in the bureaucratic set up in which importance was given on organization and administration of manpower.



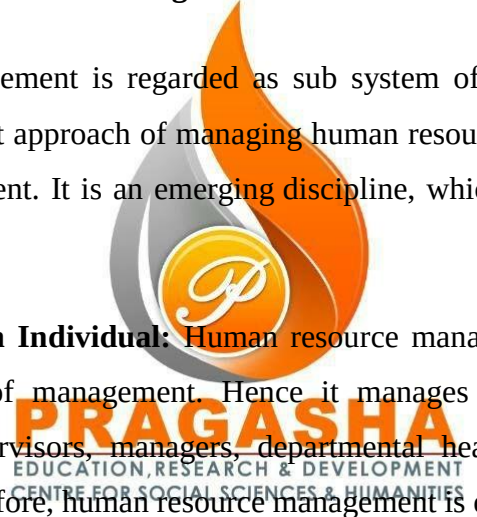
Now, human resource management may be defined as a process in which human resources are recruited and mobilized in such a way that it helps in achieving the objective of the organization. HRM is concerned with the people dimension in management under which the consideration is given towards recruitment and selection, development, motivation and maintenance of human resources in an organization. It is one of the main functions of management, which is related with the management of human energies and competencies. Human resource management helps to ensure the right man, for the right position and at the right time in a changing environment. The organizational performance depends on the efficiency of human resource working in the organization. Hence, a proper set up should be taken for manpower planning, recruitment, motivation, **training** and development, **performance evaluation**, remuneration management and industrial relation.

Moreover, human resource management is concerned with the development of human skill, knowledge and ability to perform the organizational tasks effectively and efficiently. It is a field of study consisting of four functions- acquisition, development, **motivation** and maintenance of human resources. The acquisition is related with getting people, development is with preparing them for work, motivation refers to activating them and finally maintenance refers to keeping them retained in the organization.

Therefore, human resource management is an art of managing and mobilizing people in the organization. It is done through the application of different practices and policies which ultimately values human resources as major asset of an organization. It integrates personnel function into strategic management.

Features of Human Resource Management

Human resource management is regarded as sub system of the organization. Human resource offers a distinct approach of managing human resources in today's competitive and changing environment. It is an emerging discipline, which possesses the following features:

- 
- 1. Management of An Individual:** Human resource management is concerned with people dimension of management. Hence it manages different people such as worker/labour, supervisors, managers, departmental heads and other related top managers too. Therefore, human resource management is defined as the management of human resource and their commitment towards work.
 - 2. Continuous Process:** Human resource management is not a shot affair, rather it is an ongoing process of managing people and their competencies. It is continued till the dissolution of an organization. All the processes involved in HRM should run continuously.
 - 3. Dynamic Function:** The principles and practices of HRM should not be rigid. Rather they should be dynamic. It means HRM is a dynamic function whereby the procedures and practices are influenced by the environmental factors. Employees should gain an updated knowledge and ability to work in the changing environment.
 - 4. Universal Function:** HRM is a universal function in the sense that it is applicable in all types of organizations. The principles and practices are applied irrespective of size, nature, scope and purpose of the organization.

5. **Strategic Approach:** HRM is taken as strategic approach for organizational development. It helps to mobilize human resource in the organization in order to achieve the stated goals and objectives strategically. All the activities of management are arranged in such a way that they are interconnected with efficient and effective utilization of human resources according to change in organizational strategy.
6. **Integration of Goals:** Usually there is a goal difference between organizational goal and individual goal. An employee wants to satisfy his/her individual goal first. But managers want to accomplish organizational goals before something else. Hence, HRM practices and principles help in integrating individual and organizational goal into a framework. As a result of which, employees are motivated towards higher level work performance for achievement of organizational goal.
7. **Future-oriented:** HRM is future oriented behavior in the sense that it helps in assessing human resource requirement for future. It helps in determining future goals and objectives of the organization and it employees the people to get the job done in future period of time.

FUNCTIONS OF HRM

As per Armstrong (1997) HRM is defined as “a strategic approach to acquiring, developing, managing, motivating and gaining the commitment of the organization’s key resource—the people who work in and for it.” In general, HRM is concerned with hiring, motivating and maintaining workforce within businesses. Functions of Human Resource Management Includes Managerial Functions and Operative Functions

Managerial Function Includes:

1. **Planning:** One of the primary function where number & type of employees needed to accomplish organizational goals are determined. Research forms core HRM planning which also helps management to collect, analyze and identify current plus future needs within the organization.
2. **Organizing:** Organization of the task is another important step. Task is allocated to every member as per their skills and activities are integrated towards a common goal.
3. **Directing:** This includes activating employees at different levels and making them contribute maximum towards organizational goal. Tapping maximum potentialities of an employee via constant motivation and command is a prime focus.

4. **Controlling:** Post planning, organizing and directing, performance of an employee is checked, verified and compared with goals. If actual performance is found deviated from the plan, control measures are taken.

1. Operative Function Includes:

1. **Recruitment/Hiring:** Hiring is a process which brings pool of prospective candidates who can help organization achieve their goals and allows managements to select right candidates from the given pool.
2. **Job Analysis & Design:** Describing nature of the job like qualification, skill, work experience required for specific job position is another important operative task. Whereas, job design includes outlining tasks, duties and responsibilities into a single work unit to achieve certain goal.
3. **Performance Appraisal:** Checking and analyzing employee performance is another important function that human resource management has to perform.
4. **Training & Development:** This function allows employees to acquire new skills and knowledge to perform their job effectively. Training and development also prepares employees for higher level responsibilities.
5. **Salary Administration:** Human Resource Department also determines pays for different job types and includes compensations, incentives, bonus, benefits etc. related with a job function.
6. **Employee Welfare:** This function takes care of numerous services, benefits and facilities provided to an employee for their well-being.
7. **Maintenance:** Minimizing employee turnover and sustaining best performing employees within the organization is the key. Minimizing ROI within HR department is also a key goal for Human resource management team.
8. **Labour Relations:** Labour relation is regards to the workforce who work within a trade union. Employees in such domain form a union/group to voice their decisions affectively to the higher management.
9. **Personal Research:** Research is a vital part of human resource management. It is performed to keep a check on employee opinion about wages, promotions, work condition, welfare activities, leadership, employee satisfaction and other key issues.

10. Personal Record: This function involves recording, maintaining and retrieving employee related information including employment history, work hours, earning history etc.

Role of HRM in an Organization

Human Resources Management plays a critical role in an organisation. It plays a crucial role in process of converting inputs into outputs, product design, quality maintenance, rendering services and many other functions depend largely on the human efficiency.

HR also plays significant role in managing finances and managing information systems.

HR manager also plays a vital role. His roles include role of conscience, of a counsellor, a mediator, a company spokesman, a problem solver and a change agent.

1. **The Conscience Role:** HR manager plays an important role of reminding the management its morals and obligations towards its employees.
2. **The Counsellor:** An important role of the HR manager is that of a counsellor. Whenever an employee is dissatisfied with the job he approaches the HR manager for counselling and guidance. An employee can also approach the HR manager for counselling for other problems related to his/her personal life which is likely to influence his performance like, health, children education or marriage, mental and physical problems etc. The HR manager listens to their problems and offers suggestions to solve those problems.
3. **The Mediator:** In any organisation, there are times when there are differences of opinion and misunderstanding between the management and the employee or between employees themselves. Here, HR manager acts as a mediator, a peace-maker and a communication link between them.
4. **The Spokesman:** HR manager acts as a spokes person within the company, as well as are representative of the company.
5. **The Change Agent:** Change is something always resisted by the employees. HR manager acts as a change agent in order to bring about a change on the existing system or an introduction of a new system.

- 6. The Problem Solver:** HR manager acts as a problem solver with respect to the issues that involve human resources management and over all long range organisational planning.

HUMAN RESOURCE PLANNING

It is the process of finding the right number of people for the right kind of a job, at a right time and the right place, by forecasting the organization's demand for and supply of human resources in the near future.

Benefits of Human Resource Planning

The objective of **Human Resource Planning** is to make the organization reach the desired manpower position from the current manpower position, by forecasting the demand for and supply of human resources in the near future. There are several benefits of Human resource planning that led its scope to expand across the different business organizations.

1. The human resource planning helps in forecasting the future needs of the manpower and not only this, but it also helps in anticipating the vacancies arising in the near future.
2. It is cost effective, i.e. the enterprise can anticipate the shortage and surplus of manpower and can control the imbalance that may become unmanageable or expensive.
3. Better planning for the employee development. Through human resource planning, the skills of the existing employees can be improved by giving them timely training and development opportunities.
4. Training programs become more effective since the manpower gaps, arising out of shortage or surplus, can be determined through the manpower planning and the training can be imparted accordingly.
5. It helps to make the strategic decisions related to the hiring and training of the manpower, in the case of shortage and layoff, termination or replacement of the manpower, in a case of surplus.
6. Through Human Resource planning, the idle arising out of vacancy can be reduced and thus the overall performance of the business remains unaffected.

Thus, through human resource planning the firms can effectively manage the manpower requirements (both current and future) and also helps in reducing the lead time spent on searching the prospective candidate for the vacant position.

Meaning

- Leonard Nadler introduced the term HRD in 1969. Human Resource Development (HRD) is a positive concept in human resource management.
- It is based on the belief that an investment in human beings is necessary and will invariably bring in substantial benefits to the organization in the long run.
- It aims at overall development of human resources in order to contribute other well being of the employees, organization and the society at large.

Definitions

According to Leonard Nadler - HRD is those learning experiences which are organized for a specific time and designed to bring about the possibility of behavioral change.

According to T.V. Rao - HRD is a process in which the employees of an organization are continually helped in a planned way to

- ✓ acquire  or sharpen capabilities required to perform various functions associated with their present or expected future
- ✓ (b) Develop their general capabilities so that they may be able to discover their own inner potentialities and explore them to full for their own and organizational development purpose.
- ✓ (c) Develop organizational culture where superior subordinate relationships, teamwork and collaboration among different-sub-units are strong and contribute to organizational wealth and motivation and pride of the employees.

According to Harris and Desimone - HRD is a set of systematic and planned activities designed by an organization to provide its members with the necessary skill to meet current and future job demands.

Features of HRD

- ✓ HRD is a system - interdependent parts or subsystems such as procurement, appraisal, development etc. Change in any one subsystem leads to changes in other parts.
- ✓ HRD is a planned process - It is the planned and systematic approach of developing people.
- ✓ HRD is interdisciplinary concept - It is amalgamation of various ideas, concepts, principles and practices drawn from various disciplines like sociology, economics, anthropology, psychology etc.
- ✓ HRD improves quality of work life - It is concerned with improving the skills, attitudes and behaviors of employees to benefit both the individual as well as organization.
- ✓ HRD involves development of competencies - It tries to develop competencies at four levels- individual level, interpersonal level, group level and organizational level.



Importance of HRD

- ✓ Empowers and strengthens executive skills. It enhances the capabilities of people by exploring their hidden potentials and shaping them to achieve organisation goals.
- ✓ Improves the communication system to open the channel of communication so that every one understands the other person in a better way and there is no chance of ambiguity.
- ✓ Helps the organisation in keeping the right person at the right place for the right time and making its effective use.
- ✓ Enhances the employee morale as well as develops the sense of belongingness as proper rewards are being given to the star performer.
- ✓ Improves co-ordination and co-operation which leads to cohesive groups and teams.
- ✓ Ultimately leads to overall growth and development of the employee through the above mentioned techniques,
- ✓ Provides a concrete raw material to facilitate human resource planning and control.

- ✓ Creates trust and openness among employees and develops analytical and rational skills among employees which help them in becoming more innovative, proactive and risk taking.
- ✓ Makes employees ready to change and undergo transformation and relearn after unlearning what they had already learnt.

Functions of Human Resource Development Personnel

- ✓ To develop the specific and clear HR policies and to monitor its implementation.
- ✓ To motivate all the employees to develop a desire to learn and develop consistently.
- ✓ To design innovative ways and systems to develop and strengthen the HRD.
- ✓ To be aware of the organizational objectives and focus all HRD effort to achieve these goals.
- ✓ To develop perfect co-ordination between trade unions and other regulatory bodies
- ✓ To develop research development centers and motivate people to undergo research processes and come out with new ideas and concepts

HRM Models



1. The Fombrun Model
2. The Harvard Model
3. The Guest Model and
4. The Warwick Model

All these models serve the following purposes:

- They provide an analytical framework for studying HRM for example, situational factors, stakeholders, strategic choice levels, competence etc.
- They validate certain HRM practices and provide distinctiveness to HRM practices.

- They provide a characterization of HRM that establishes variables and relationship to be researched.
- They help to discover and understand the world for explaining the nature and significance of key HR practices.

The Fombrun Model

- ✓ This is the model of HRM
- ✓ It emphasizes four functions of management and their interrelatedness Selection, Appraisal, Development and Rewards.
- ✓ This model is incomplete as it focuses on only four functions of HRM and ignores all other environmental and contingency factors.
- ✓ But, this model is simple and can serve as a heuristic framework for explaining the nature and significance of HR activities.

The Harvard Model

- ✓ This model consists six critical components of HRM namely stake holders interests, situational factors, HRM policy choices, HR out comes, long term consequences and a feedback loop through.

The Guest Model

- ✓ This model was developed by David Guest in 1997.
- ✓ This model emphasizes on the assumption that HR manager has specific strategies to begin with, which demand certain practices and when executed will result in outcomes.
- ✓ These out comes include behavioral performance related and financial rewards.
- ✓ The model emphasizes the logical sequence of six components: HR strategy, HR practices, HR outcomes, Behavioral outcomes, Performance results and financial consequences.

The Warwick Model

- ✓ This model was developed by two researchers, Hendry and Pettigrew of University of Warwick (hence the name Warwick model).
- ✓ Like other human resource management models, the Warwick proposition centers around five elements-
 - Outer context (macro environmental forces)
 - Inner context (firm specific or micro environmental forces)
 - Business strategy content
 - HRM context
 - HRM content
- ✓ The strength of this model is that it identifies and classifies important environment influences on HRM.
- ✓ This model takes cognizance of business strategy and HR practices, the external and internal content, in which these activities take place and process by which such changes take place including transactions between changes in both external content and internal content.

Human Resource Planning Process

The **Human Resource Planning** is a process of forecasting the organization's demand for and supply of manpower needs in the near future.

Human Resource Planning Process

1. Determining the Objectives of Human Resource Planning
2. Analyzing Current Manpower Inventory
3. Forecasting Demand and Supply of Human Resources
4. Analyzing the Manpower Gaps
5. Employment Plan/Action Plan
6. Training and Development
7. Appraisal of Manpower Planning

Thus, human resource planning is a continuous process that begins with the objectives of Human Resource planning and ends with the appraisal or feedback and control of the planning process.

Limitations of Human Resource Planning

The Human Resource Planning is concerned with maintaining and recruiting the human resources with the requisite quantity and the quality, to fulfill the demand and supply arising in the near future. In spite of its benefit of keeping the organization's manpower position balanced, there are a few limitations of Human Resource Planning, which are discussed below.

1. The future is uncertain. There are several external factors viz. Technological, political, cultural, etc. that affects the employment opportunities. Therefore, the management can consider the human resource planning as a guiding factor and can not rely completely on it.
2. With the surplus manpower, the companies try to remove this imbalance using termination, layoff, removal of the existing employees. This could create a sense of insecurity among them, and that would result in the loss of their faith in the company.
3. The human resource planning is time-consuming since it collects the complete information regarding the personnel requirements of each department and then finds the suitable sources to satisfy the needs.
4. The human resource planning is an expensive process. All the activities carried out from the time the manpower need arises till the final placement of employees, consumes lot of time and is very expensive.

Thus, the firm must carry out the human resource planning cautiously since it is accorded with several limitations that can adversely affect the overall functioning of the firm.

Recruitment Process

The **Recruitment** is the process of analyzing the job requirements and then finding the prospective candidates who are then encouraged and stimulated to apply for the job in the organization.

The Recruitment programme is designed to attract more and more applicants such that the pool of candidates applies for the job, and the organization has more options to select the best out of them. The recruitment process consists of five interrelated stages which are as follows:

1. **Recruitment Planning:** The recruitment process begins with the planning where in the vacant job positions are analyzed and then the comprehensive job draft is prepared that includes: job specifications and its nature, skills, qualifications, experience needed for the job, etc.

Here, the recruitment committee decides on the number and the type of applicants to be contacted. The aim of any organization is to attract more candidates as some of them might not be willing to join, or some might not qualify for the job position. So the company has a sufficient number of candidates to choose amongst them. The type of candidates required for the job is well specified in terms of the task and responsibilities involved in a job along with the qualification and experience expected.

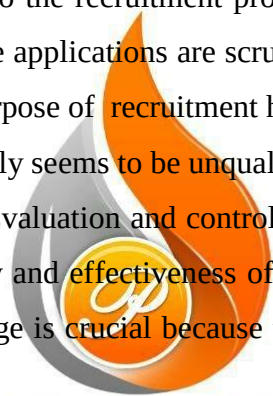
2. **Strategy Development:** Once the comprehensive job draft is prepared, and the type and the number of recruits required are decided upon; the next step is to decide a strategy that is adopted while recruiting the prospective candidates in the organization. The following strategic considerations should be kept in mind:

- **Make or Buy Employees,** which means the firm either decides to select less skilled employees and invest in training and education programmes or hire skilled professionals.
- **Methods of Recruitment,** the firm decide on the methods used for recruiting the individuals. Such as the internet provides detailed information about the prospective candidates and helps in shortlisting the best-qualified individuals.
- **Geographical Area,** the next decision is related to the area from where the candidates shall be searched. The firm looks for those areas where the handful amount of qualified employees is concentrated, with a view to curtailing a search cost.
- **Sources of Recruitment,** there are two sources of recruitment: Internal source (within the organization), external source (outside the organization). The firm must decide the source from where the candidates are hired.

3. **Searching:** Once the strategy is prepared the search for the candidates can be initialized. It includes two steps: **source activation and selling**. The source activation means, the search for the candidate activates on the employee requisition i.e. until and unless the line manager verifies that the vacancy exists, the search process cannot be initiated.

The next point to be considered is selling, which means the firm must judiciously select that media of communication that successfully conveys the employment information to the prospective candidates.

4. **Screening:** The screening means to shortlist the applications of the candidates for further selection process. Although, the screening is considered as the starting point of selection but is integral to the recruitment process. This is because the selection process begins only after the applications are scrutinized and shortlisted on the basis of job requirements. The purpose of recruitment here is to remove those applications at an early stage which clearly seems to be unqualified for the job.
5. **Evaluation and Control:** Evaluation and control is the last stage in the recruitment process wherein the validity and effectiveness of the process and the methods used therein is assessed. This stage is crucial because the firm has to check the output in terms of the cost incurred.



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The recruitment is a costly process as it includes the salaries of recruiters, time spent by the management, cost of advertisement, cost of selection, a price paid for the overtime and outsourcing in case the vacancy remains unfilled. Thus, a firm is required to gather all these relevant information to evaluate the performance of a recruitment process effectively.

Sources of recruitment

1. Internal Source of Recruitment

2. External Source of Recruitment

Internal sources of recruitment

Internal sources of recruitment involve motivating the employees of the organization to apply for the openings within the organization. Job openings are informed to the employees of the same organization by giving internal advertisements, word of mouth or communication through the hierarchy. Many organizations are practicing this approach to motivate the skilled employees of the organization, to reduce the employee turnover, to reduce the cost and to get a competitive advantage. Various methods of internal sources or recruitment are as follows.

1. **1.Transfers:** The employees of the organization are transferred to the similar jobs of other departments. It may not involve a change in salary, responsibility, and position of the job. Transfers help in reducing the boredom and monotony of the employees or it may be used to fill the vacancies with suitable internal candidates.
2. **2.Promotions:** Promotions involve vacancies of the organization are filled by promoting the skilled employees to the suitable jobs and it can motivate the employees by giving higher position, increased salary, status, and responsibility. Promotions can help in reducing employee turnover by creating the hope of getting higher positions.
3. **3.Demotions:** Depending on the performance of the employees of the organizations, sometimes managers have to take decisions regarding lowering the positions of few employees of the organization. These employees can act as a source of recruitment to the lower positions.
4. **4.Employees of the organization:** Employees of the organization communicate or inform about the vacant positions of the organization to their friends and relatives. In many organizations, they allowed referring potential candidates for the suitable vacancies.
5. **5.Retired employees:** If the organizations do not find the right persons to fulfill the key managerial positions then they call back the retired employees for achieving the objectives.

Advantages of internal sources recruitment

- When the existed employees are given a chance to get the higher positions of the organization then the employee loyalty increases towards the organization.
- It highly motivates the employees and helps in maximizing the job satisfaction.

- Existed employees of the organization are well known about the organization culture.
- Internal sources of recruitment highly reduce efforts and cost.
- It helps in reducing the employee turnover.
- It creates a scope to get a competitive advantage by recruiting the skilled employees for the higher positions.
- It helps in maximizing job security and job satisfaction
- Transfers from one department to another department helps in eliminating boredom and monotony in employees.
- It helps in reducing the efforts of induction programs.

Disadvantages of internal sources of recruitment

- Internal sources of recruitment reduce the scope of finding skilled and more efficient people.
- The introduction of new methods and strategies may not always possible with this approach.
- Losing more efficient persons from the external environment becomes a competitive advantage to the competitors.
- This approach is not suitable for all the organizations



External Sources of Recruitment

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The External Sources of Recruitment mean hiring people from outside the organization. In other words, seeking applicants from those who are external to the organization.

There are several methods for external recruiting. The firm must carefully analyze the vacant positions and then use the method which best fulfills the requirement. Following are the different types of external sources of recruitment:

1. **Media Advertisement:** The advertisement is the most common and preferred source of external recruiting. The ads in newspapers, professional journals, give a comprehensive detail about the organization, type, and nature of job position, skills required, qualification and experience expected, etc. This helps an individual to self-evaluate himself against the job requirements and apply for the jobs which best suits him.

2. **Employment Exchange:** The employment exchange is the office run by the government wherein the details about the job seekers such as name, qualification, experience, etc. is stored and is given to the employers who are searching for men for their organizations. For certain job vacancies, it is mandatory for every organization to provide details about it to the employment exchange. It is the most common source of external recruitment that offers jobs to unskilled, semi-skilled and skilled workers.
3. **Direct Recruitment:** The direct recruitment also called as factory gate recruitment is an important source of hiring, especially the unskilled workers or badli workers who are paid on a daily-wage basis. Here, the company puts up a notice on a notice board or on the factory gate regarding the jobs available, such that the applicant sees it and apply for the job directly.
4. **Casual Callers:** The casual callers, also called as unsolicited applications are the job seekers who come to the well-renowned organizations casually and either mail or drop in their job applications seeking the job opportunity. This could be considered as an important source of external recruitment as the personnel department maintains the folder of unsolicited applications and call those who fulfill the job requirements, whenever the vacancy arises.
5. **Educational Institutions or Campus Placement:** Creating a close liaison with the educational institutes for the recruitment of students with technical and professional qualifications has become a common practice of external recruitment. Here, the companies, visit the technical, management and professional colleges to recruit the students directly for the job positions. The recruitment from educational institutions is also termed as campus recruitment.
6. **Labour Contractors:** This is the most common form of external recruitment wherein the labour contractors who are either employed with the firm or have an agreement to supply workers to the firm for the completion of a specific type of a task. This method is again used for hiring the unskilled and semi-skilled workers. The contractor keeps in touch with the workers and sends them to the places where their need arises. In doing so, the contractors get the commission for each worker supplied.
7. **Walk-Ins:** This is again a direct form of recruitment wherein the prospective candidates are invited through an advertisement to come and apply for the job vacancy. Here, the specified date, venue, and time are mentioned, and the candidates are requested to come and give interviews directly without submitting their applications in advance.

8. **E-recruiting:** The e-recruiting means searching and screening the prospective candidates electronically. There are several online job portals that enable the job seekers to upload their resume online which are then forwarded to the potential hirers. Such as naukri.com, monster.com, shine.com, etc. are some of the well renowned online job portals.
9. **Management Consultants:** There are several private management firms that act as a middleman between the recruiter and the recruit. These firms help the organization to hire professional, technical and managerial personnel, and they specialize in recruiting middle level and top level executives. These firms maintain data of all the job seekers, such as education, qualification, experience, etc. and give their details to the companies who are looking for men. Nowadays, the engineers, accountants, lawyers help their counterparts to get suitable jobs in industrial organizations.

These are some of the commonly used methods of external recruiting that companies select depending on the nature of the job position and the number and type of candidates to be reached out.

Alternatives to Recruitment

The Alternatives to Recruitment are the temporary ways of hiring people for the job position with a view to saving cost incurred in recruiting process and meet the short-term demand for increased work volume. The recruitment is the costly process which includes the salaries of recruiters, cost incurred in advertisements, time spent by the management, cost of hiring new recruits, etc. Thus, in order to meet the short-term fluctuations in the work volume, organizations might resort to the temporary recruitment alternatives than a full-fledged recruitment.

Alternatives to Recruitment

1. **Overtime:** In case the demand for a product peaks due to the temporary market fluctuations, then a firm asks its employees to work extra despite recruiting new hands. The overtime benefits both the employee and the employer as the former fetches extra income for the additional piece of work while the latter saves cost incurred in recruiting new persons. But however, an overtime leads to fatigue, reduces the productivity of an employee and ultimately leads to more accidents and absenteeism.

2. **Employee Leasing:** The employee leasing is another form of alternative to recruitment wherein the company pays a fee to the leasing firm or the consultancy that handles employee benefits, payroll, and all other HR functions on behalf of the client company. The employee leasing is also called as “**staff outsourcing**” wherein the permanent employees of other firms are hired due to their specialization in a certain field on a lease basis to meet the short term requirements of the client company. Here the individuals work for the leasing firm.
3. **Subcontracting:** The subcontracting is a business practice wherein a certain portion of the work is delegated to other specialized agencies to meet a surge in the demand for goods and services. Here, the contractor with a mutual consent assigns some task to some other specialist contractor who helps in completing the project. The subcontracting is prevalent in the complex jobs such as construction, building, and information technology.
4. **Temporary Employment:** The temporary employees are those who are hired for a specific time period until the task gets accomplished. Earlier the temporary employment agencies were used in hiring the unskilled and semi-skilled labourers, but nowadays the employees are readily available for the technical, professional and executive positions as well.
5. The temporary employment is beneficial for the firms as the cost of labour is relatively less, services of an experienced labour can be utilized, and there is flexibility in responding to the future needs of workers. But however, temporary employment lacks labour commitment to the organizational goals since the workers hired do not know about the culture and workflow of the firm.
6. **Outsourcing:** Often the companies outsource or assign the task of recruitment to the third party specialist, who then carry out all the recruitment activities which would have been done in-house otherwise. It is beneficial for the firms which are small and have a lack of expertise in recruitment to delegate the authority to the third party to carry out the recruitments on the company’s behalf. But the responsibility lies with the client company itself and must ensure that all the activities related to recruitment are performed effectively by the third party.

Thus, these alternatives to recruitment help any organization to employ the staff temporarily and save huge costs incurred in the recruitment process. These methods offer

an opportunity to any organization to capitalize on the expertise of the employees for a specific time period if not wanted it to be permanent.

E-Recruitment

The **E-Recruitment**, also called as **Online Recruitment**, is the process of hiring the potential candidates for the vacant job positions, using the electronic resources, particularly the internet. Generally, the job vacancies are advertised on the world wide web (www), where the applicants attach their CV or resume, to get recognized by the potential recruiters or the employers.

Advantages of E-Recruitment

- Low cost per candidate, as compared to the physical recruitment process.
- Wide geographical coverage, i.e. the candidates can be hired from any part of the world.
- Beneficial for both the employer and the job seeker, the corporations can find the prospective candidates through their CVs attached to world wide web, and similarly, the candidates can search the employer through their job vacancy advertisement posted on the internet.
- Less time required in hiring the potential candidate for the firm.
- Right people for the right job can be easily found through E-Recruitment, by matching the candidate's CVs with the job profile.
- The recruitment process becomes more efficient and easy to record details of the applicant.
- The E-Recruitment software and systems are available, through which the entire recruitment process becomes automated. One of the systems is the **Recruitment Management System**, which is a portal that involves hiring the candidates online and each step involved in the recruitment process is automatized.

SELECTION

The Selection is the process of choosing the most suitable candidate for the vacant position in the organization. In other words, selection means weeding out unsuitable applicants and selecting those individuals with prerequisite qualifications and capabilities

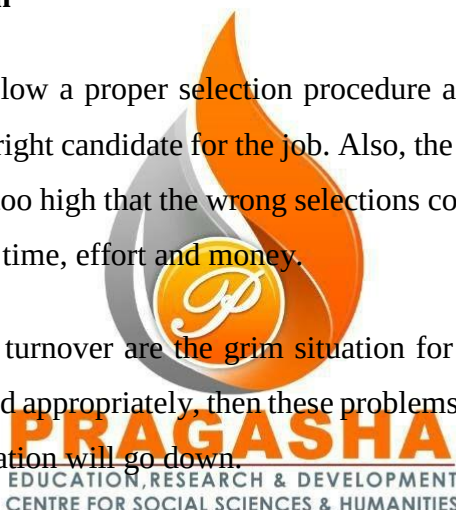
to fill the jobs in the organization. Based on the complexity of selecting the right candidate the selection process is comprised of several steps:

1. Preliminary Interview
2. Receiving Applications
3. Screening of Applications
4. Employment Tests
5. Interview
6. Reference Checking
7. Medical Examination
8. Final Selection

Significance of Selection

The company should follow a proper selection procedure as huge amount of money is invested in selecting the right candidate for the job. Also, the cost incurred in training and induction programme is too high that the wrong selections could lead to a huge loss to the employer in terms of the time, effort and money.

Absenteeism and labour turnover are the grim situation for any organization and if the candidates are not selected appropriately, then these problems will increase and the overall efficiency of the organization will go down.



Selection Process

Definition: The **Selection** is a process of picking the right candidate with prerequisite qualifications and capabilities to fill the jobs in the organization.

The selection procedure comprises of following systematic steps:

1. **Preliminary Interview:** The preliminary interview is also called as a screening interview wherein those candidates are eliminated from the further selection process who do not meet the minimum eligibility criteria as required by the organization. Here, the individuals are checked for their academic qualifications, skill sets, family backgrounds and their interest in working with the firm. The preliminary interview is

less formal and is basically done to weed out the unsuitable candidates very much before proceeding with a full-fledged selection process.

2. **Receiving Applications:** Once the individual qualifies the preliminary interview he is required to fill in the application form in the prescribed format. This application contains the candidate data such as age, qualification, experience, etc. This information helps the interviewer to get the fair idea about the candidate and formulate questions to get more information about him.
3. **Screening Applications:** Once the applications are received, these are screened by the screening committee, who then prepare a list of those applicants whom they find suitable for the interviews. The shortlisting criteria could be the age, sex, qualification, experience of an individual. Once the list is prepared, the qualified candidates are called for the interview either through a registered mail or e-mails.
4. **Employment Tests:** In order to check the mental ability and skill set of an individual, several tests are conducted. Such as intelligence tests, aptitude tests, interest tests, psychological tests, personality tests, etc. These tests are conducted to judge the suitability of the candidate for the job.
5. **Employment Interview:** The one on one session with the candidate is conducted to gain more insights about him. Here, the interviewer asks questions from the applicant to discover more about him and to give him the accurate picture of the kind of a job he is required to perform. Also, the briefing of certain organizational policies is done, which is crucial in the performance of the job. Through an interview, it is easier for the employer to understand the candidate's expectations from the job and also his communication skills along with the confidence level can be checked at this stage.
6. **Checking References:** The firms usually ask for the references from the candidate to cross check the authenticity of the information provided by him. These references could be from the education institute from where the candidate has completed his studies or from his previous employment where he was formerly engaged. These references are checked to know the conduct and behavior of an individual and also his potential of learning new jobs.
7. **Medical Examination:** Here the physical and mental fitness of the candidate are checked to ensure that he is capable of performing the job. In some organizations, the medical examination is done at the very beginning of the selection process while in some cases it is done after the final selection.

Thus, this stage is not rigid and can take place anywhere in the process. The medical examination is an important step in the selection process as it helps in ascertaining the applicant's physical ability to fulfill the job requirements.

8. **Final Selection:** Finally, the candidate who qualifies all the rounds of a selection process is given the appointment letter to join the firm.

Thus, the selection is complex and a lengthy process as it involves several stages than an individual has to qualify before getting finally selected for the job.

JOB ANALYSIS

Job analysis refers to **the process of systematically identifying, obtaining and recording all the facts and details concerning the job** through various methods. It encompasses gathering information related to the knowledge, skills and abilities (**KSA**) which the job holder must have, to perform the job satisfactorily. Job analysis helps in placing **the right person in the right job**. For this purpose, the analyst must identify the activities involved, tasks to be performed, the way tasks are accomplished and the essential qualities possessed by the incumbent for the completion of the tasks effectively.

Process of Job Analysis

1. **Strategic Choices:** Firstly, an organisation needs to make strategic choices, concerning the job analysis. These choices are related to:

- Degree to which an employee is involved in the process.
- Sources of collecting information.
- When and How often analysis is conducted.
- Level to which details are to be collected.
- Orientation, i.e. past and future.

2. **Collection of Information:** In the next step data is gathered, which mainly deals with three aspects:

- **Type of data to be obtained:** It focuses on the basic job needs

- **Person who collects the data:** He/She may be the job analyst, supervisor or incumbent.
 - **Methods applied in collecting data:** A number of techniques can be applied which may be an interview, checklists, questionnaire, diary method, observation and so forth.
3. **Process Information:** Once the information is collected by the concerned individual, it is then transformed in a way, so that it helps in job documentation.
 4. **Job Description:** The processed data will result in job description which describes the entire **job profile** to the management and the incumbent as well. It lists out the job title, duties, responsibilities, tasks, activities, scope of work, objectives, authority limits, etc.
 5. **Job Specification:** Job specification specifies all the **employee qualifications**, in the sense of physical, mental, emotional and behavioural abilities.

It highlights the educational qualification, experience, knowledge, skills mental abilities, age, gender, aptitude, reasoning, etc. possessed by the incumbent to perform the job and the duties related to it satisfactorily.

The data gathered through job analysis is useful for various human resource functions such as Human resource planning, recruitment and selection, induction, training, job evaluation, remuneration, performance appraisal, health and safety, promotion and transfer, career planning, and so on.

An ideal job analysis covers all the important aspects such as tasks and duties

JOB DESCRIPTION

Job description is an informative documentation of the scope, duties, tasks, responsibilities and working conditions related to the job listing in the organization through the process of job analysis. Job Description also details the skills and qualifications that an individual applying for the job needs to possess. It basically gives all the details which might be good for both the company and the applicant so that both parties are on the same page regarding the job posting. Basically, **job analysis** is bifurcated into two components namely job description and **job specification**.

The job description is used in the recruitment process to inform the applicants of the job profile and requirements, and used at the performance management process to evaluate the employee's performance against the description.

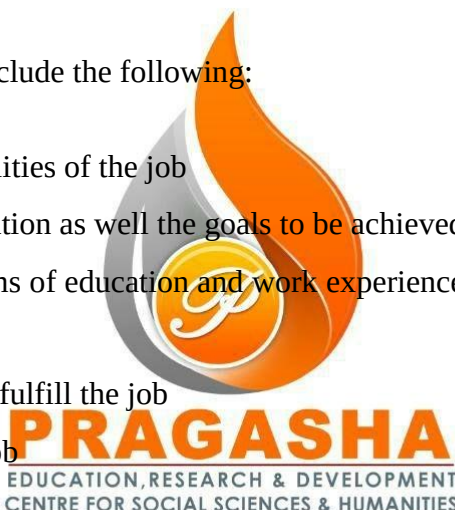
Importance of Job Description

Job description is the most important thing which a candidate gets about a job listing. Job description gives all the relevant and necessary details about a job. The details which can help one decide whether the job is relevant or not. Qualifications, roles, responsibilities etc are included in the job description document which paints a clear picture of what is expected from the particular role.

Job Description Components

A Job description will include the following:

- Roles and responsibilities of the job
- Goals of the organization as well the goals to be achieved as a part of the profile
- Qualifications in terms of education and work experience required have to be clearly mentioned
- Skill sets required to fulfill the job
- Salary range of the job



Advantages of Job Description

There are many benefits of having a comprehensive job description given by a company. Some of the advantages of job description are mentioned below:

1. Helps companies understand the type of candidate they should search for based on title, position and location
2. Employees are well aware about their job roles & duties
3. Job description helps in understanding the workplace environment, benefits etc for a prospective employee
4. Helps in better recruitment & selection
5. Job description clearly highlights all the requirements, objectives & goals that it wants an employee to perform

Disadvantages of Job Description

Despite being a thorough documentation related to the job, there are certain limitation of job description:

1. Job descriptions are time bound and can change with organization structure, industry policies, company requirements etc
2. It can only highlight the macro criteria of a job but cannot fully explain the obstacles, emotional requirements etc related to the job
3. Incomplete job description lacking quality information can misguide both the HR manager as well as the employee

JOB SPECIFICATION

A job specification defines the knowledge, skills and abilities that are required to perform a job in an organization. Job specification covers aspects like education, work-experience, managerial experience etc which can help accomplish the goals related to the job. Job specification helps in the recruitment & selection process, evaluating the performance of employees and in their appraisal & promotion. Job specification, along with **job description**, is actually derived from **job analysis**. Collectively, job specification and job description help in giving a overview of the job in terms of its title, position, roles, responsibilities, education, experience, workplace etc.



Importance of Job Specification

The importance and purpose of job specification is a thoroughly understand the specific details of a job. Jobs can be of different types and can require a different skill sets to get the maximum output from a particular. Job specification gives important details related to the job like education & skills, prior work experience, managerial experience, personality traits etc which would help an employee accomplish the objectives of a job. For a recruiter, job specification lays down the guidelines basis of which the company can recruit and select the best possible candidate who would be best suited for the job. Apart from actually finding the right candidate or employee, job specification can be used for screening of resumes & shortlist only those candidates who are the closest fit to the job.

Hence, a job specification gives specific details about a job and what kind of skill sets are required to complete the job.

Components of Job Specification

There are many parameters which are considered while giving the job specification for a certain profile.

1. **Educational Qualification:** This parameter gives an insight on how qualified a certain individual is. It covers their basic school education, graduation, masters degree, other certifications etc
2. **Experience:** Job specification clearly highlights the experience required in a particular domain for completing a specific job. It includes work experience which can be from a specific industry, position, duration or in a particular domain. Managerial experience in handling and managing a team can also be a job specification criteria required for a particular position
3. **Skills & Knowledge:** This is an important parameter in job specification especially with knowledge and skill based profiles. The higher the position in a company, the more niche the skills become and more is the knowledge required to perform the job.
4. **Personality traits and characteristics:** The way in which a person behaves in a particular situation, handles complex problems, generic behaviour etc are all covered in the characteristics of a job description. It also covers the emotional intelligence of a person i.e how strong or weak a person is emotionally

Advantages of Job Specification

There are several benefits of having a comprehensive job specification. Some advantages are listed below:

1. Job specification highlights all the specific details required to perform the job at its best
2. It gives the HR managers a threshold and a framework on the basis on which they can identify the best prospects
3. Helps in screening of resumes and saves time when there are multiple applications by choosing those who are closest to the job specification

4. HR managers can use job specification as a benchmark to evaluate employees and give them required trainings
5. It also helps companies during performance appraisal and promotions

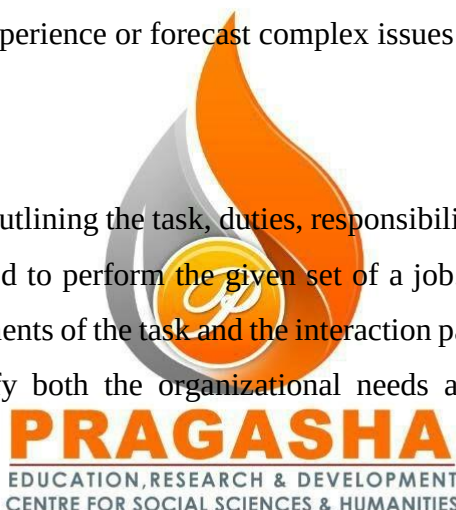
Disadvantages of Job Specification

There are certain limitations of job specification. Some of the disadvantages are mentioned below:

1. It is a time consuming process as it has to be very thorough and complete
2. Job description is time bound and changes with changing technology and changing knowledge & skill requirements
3. It can only give a framework of emotional characteristics and personality traits but cannot specify the experience or forecast complex issues

JOB DESIGN

The **Job Design** means outlining the task, duties, responsibilities, qualifications, methods and relationships required to perform the given set of a job. In other words, job design encompasses the components of the task and the interaction pattern among the employees, with the intent to satisfy both the organizational needs and the social needs of the jobholder.



The objective of a job design is to arrange the work in such a manner so as to reduce the boredom and dissatisfaction among the employees, arising due to the repetitive nature of the task.

There are several important methods and techniques that the management uses while designing the jobs. These are:

1. Job Simplification
2. Job Rotation
3. Job Enrichment
4. Job Enlargement

While designing the job, the following aspects are to be taken into the consideration:

1. The foremost requirement for a job design is to define clearly the **task** an individual is supposed to perform. A task is the piece of work assigned to the individual and who has to perform it within the given time limits.
2. The management must decide on the level of **motivation** that is required to be enforced on an individual to get the work completed successfully. Thus, the managers must design the jobs that motivate his employees.
3. The managers must decide critically on the amount of **resources** that needs to be allocated to perform a particular type of a job. Thus, the efforts should be made to make an optimum utilization of organizational resources while designing the job so that the organization does not suffer any dilemma due to the shortage of its resources.
4. When the jobs are assigned to the individual, he agrees to do it because of the **rewards** attached to it. Thus, the manager must include in the job design the compensation, bonuses, incentives, benefits and other remuneration method for the employees.

Thus, the job should be designed with the intent to find a fit between the job and its performer, such that the job is performed efficiently, and the performer experiences satisfaction while performing it and give his best efforts towards its completion.

Job Simplification

The **Job Simplification** means breaking the job into relatively easier sub-parts with the intention to enhance the individual's productivity by minimizing the physical and mental efforts required to perform a complex job.

Job Rotation

Job Rotation is the management technique wherein an employee is shifted from one job role to the other, with the purpose of familiarizing him with all the verticals of an organization.

Advantages of Job Rotation

1. Reduces the monotony of work
2. Broadens one's knowledge and skills
3. Helps the management to explore the hidden talent of an individual
4. Helps an individual to realize his own interest

5. Helps in creating the right employee job fit
6. Developing a wider range of experience

Disadvantages of Job Rotation

1. Reduces uniformity of work
2. Fear of performing another task effectively
3. Frequent interruptions in the work
4. Misunderstanding between the team members or union.
5. Difficulty in coping with other team members
6. Fear of getting more tedious or a hectic work

The job rotation is beneficial for both the employer and the employee. The employer can identify the vertical where the employee is giving his best and can also place him in the position of a person who has left because of the retirement, transfer, termination or any other reason.

Likewise, an individual also gets a chance to realize his efficiency and explore his own interest. Through job rotation, an employee acquires several skill sets which are necessary at different point of times.

Job Enlargement



The **Job Enlargement** refers to the horizontal expansion of jobs wherein more and more activities, and tasks are added to the existing job scope at the same level in the organization.

In other words, job enlargement means increasing the scope of duties and responsibilities of an individual by adding the related activities to his existing job profile and generally without any change in his authority and his level in the hierarchy in the organization.

The purpose behind the job enlargement is to increase the employee flexibility and reduce the monotony that occurs gradually over a period of time. Often, the employees are not required to get the training for the task-related activities because he is already aware of that and is doing for quite some time. But however, if the activity added is new for an

employee and is not related to his existing job nature, then a proper training should be given to him in order to acquaint himself with the new job conditions.

Thus, job enrichment is a job design technique which is used to broaden the scope of the employee's activities with the intent to increase his responsibility and duties and minimize the boredom that he may be facing with his existing job duties. But however, the employee can consider this approach as a negative step taken by the management; wherein he is required to do more task or activities for the same amount of pay.

Job Enrichment

The **Job Enrichment** is the job design technique used to increase the satisfaction among the employees by delegating higher authority and responsibility to them and thereby enabling them to use their abilities to the fullest.

In other words, job enrichment is the opportunity given to the employees to explore their abilities when some tough task is assigned to them. The job enrichment is the vertical restructuring of moral excellence in which more authority, autonomy, control is given to the employees to perform a given set of a job. This concept is in contrast to the job enlargement which considers the horizontal restructuring, where more and more tasks get added, and the challenge remains the same.

Thus, job enrichment is characterized by the different range of tasks and challenges having varying levels of difficulties. The organization can realize benefits through this job design technique in any of the following ways:

- With an increase in the employee morale, the more motivated, he gets to produce top results and hence, the profitability of the firm increases.
- When the employees bear more responsibility for their work and results, it becomes quite easy for the organization to operate.
- By giving authority to the employees to perform higher level jobs, the company is preparing its employees to occupy those high-level positions in the near future.
- Also, with the job enrichment, the number of levels in the management may reduce, thereby minimizing the complexity of the organization.

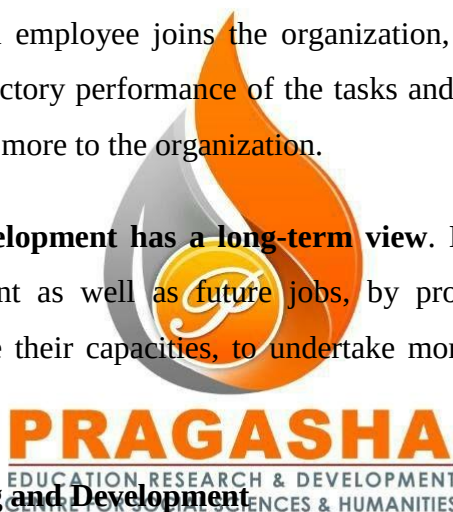
The purpose behind the job enrichment is to motivate the employees to use their abilities which remained unused during their course of action. Also, through job enrichment, the monotony breaks and the employees get the opportunity to do something new, which ultimately results in the increased satisfaction levels.

Training and Development

Employee training and development implies a program in which specific knowledge, skills and abilities are imparted to the employees, with the aim of raising their performance level, in their existing roles, as well as providing them learning opportunities, to further their growth.

Training implies a process of upgrading an individual's knowledge, skills and competencies. When an employee joins the organization, he/she is given job-related training to ensure satisfactory performance of the tasks and duties assigned, so that the employee can contribute more to the organization.

On the other hand, **development has a long-term view.** It is all about preparing the employee for the current as well as future jobs, by providing them with learning opportunities to increase their capacities, to undertake more challenging and complex tasks.



Importance of Training and Development

For organization:

1. Training and Development programme facilitates **better utilization of an organization's resources**, i.e. men, machine, material and money.
2. It ensures **less wastage, with respect to resources and time.** When a worker is skilled and trained enough, the amount of wastage will be less, as well as the learning time will be reduced, and the work will be performed in very less time.
3. It **improves the performance** of the employee which results in increased profitability.
4. The employees learn **new and improved methods of performing an activity**, which helps the organization to survive, compete and grow in the market.
5. It results in a **reduction in employee turnover, idle time and absenteeism.**

6. It develops a **positive attitude** in employees towards the work and organization, as well as boosts their morale, which helps them adapt themselves to the changing environment.

For Employees:

1. An individual focuses more on career than a job. And so, the **skills and knowledge acquired from the training add to their resume.**
2. Improved performance is a sort of **motivation** for an individual which encourages them to perform much better than before and contribute to the organization's success, which ultimately increases their incentives.
3. When an employee is trained enough, he/she will **handle any situation or problem and deal with the challenges** in a better way.
4. Training makes workers machine or equipment-friendly, which **reduces the number of accidents** during the process.
5. It helps the employee to **stay up-to-date with the technological changes.**
6. It results in **job satisfaction and boosts employees morale.**

Training is often imparted to middle or low-level employees. In contrast, the development programmes are specifically designed for the employees working in higher positions in the organisational hierarchy.



Inputs in Training and Development

- **Skills:** Basic skills should be imparted to the workers, to help them operate the machinery and other equipment correctly, with least wastage and damage.
- **Education:** It aims at teaching theoretical concepts along with providing a hands-on experience to the employee. It also improves their judgement and reasoning power.
- **Development:** Training involves development, wherein more stress is given on increasing knowledge, rather than the skills. Here, knowledge means an understanding of the business environment, human relations, management, etc.
- **Ethics:** Ethics are the principles that regulate the conduct of an employee, at the time of undertaking any activity. So, the training and development programme must provide knowledge regarding ethical conduct.

- **Change in attitude:** One of the important benefits of training is the attitudinal changes in employees. Attitude indicates the feelings, outlook, reaction and beliefs of the employee towards others. It has a great impact on an employee's morale, motivation, loyalty, commitment and satisfaction.
- **Extraordinary Skills:** Apart from basic skills, training and development scheme should impart some other skills to higher level employees such as problem-solving, decision making, industrial analysis, etc.
- **Literacy:** Here literacy is not related to education, but proficiency in the corporate language and he/she must be fully aware of the corporate culture, to deal with international clients and customers.

In a nutshell, any activity that intends to **enhance the present or future performance of an employee**, by improving his/her ability through the process of learning, by changing approach, sharpening skills, strengthening competencies and increasing the knowledge base, comes under the ambit of training and development.

Training Process

Definition: The **Training Process** comprises of a series of steps that needs to be followed systematically to have an efficient training programme. The Training is a systematic activity performed to modify the skills, attitudes and the behavior of an employee to perform a particular job.



Training Process

1. **Needs assessment:** The first step in the training process is to assess the need for training the employees. The need for training could be identified through a diagnosis of present and future challenges and through a gap between the employee's actual performance and the standard performance. The needs assessment can be studied from two perspectives: Individual and group. The individual training is designed to enhance the individual's efficiency when not performing adequately. And whereas the group training is intended to inculcate the new changes in the employees due to a change in the organization's strategy.
2. **Deriving Instructional Objectives:** Once the needs are identified, the objectives for which the training is to be conducted are established. The objectives could be

based on the gaps seen in the training programmes conducted earlier and the skill sets developed by the employees.

3. **Designing Training Programme:** The next step is to design the training programme in line with the set objectives. Every training programme encompasses certain issues such as: Who are the trainees? Who are the trainers? What methods are to be used for the training? What will be the level of training? etc. Also, the comprehensive action plan is designed that includes the training content, material, learning theories, instructional design, and the other training requisites.
4. **Implementation of the Training Programme:** Once the designing of the training programme is completed, the next step is to put it into the action. The foremost decision that needs to be made is where the training will be conducted either in-house or outside the organization. Once it is decided, the time for the training is set along with the trainer who will be conducting the training session. Also, the trainees are monitored continuously throughout the training programme to see if it's effective and is able to retain the employee's interest.
5. **Evaluation of the Training Programme:** After the training is done, the employees are asked to give their feedback on the training session and whether they felt useful or not. Through feedback, an organization can determine the weak spots if any, and can rectify it in the next session. The evaluation of the training programme is a must because companies invest huge amounts in these sessions and must know it's effectiveness in terms of money.
6. Thus, every firm follows the series of steps to design an effective training programme that serves the purpose for which it was intended.

Types of Training

Training is an organized activity conducted to improve the performance of an employee and to bring about a considerable change in the skills, knowledge, attitude, behavior for performing a particular kind of a job. There are several types of training programs which are carried out in the different business situations.

Types of Training

1. **Induction or Orientation Training:** Introducing a new employee to the organization's environment comprising of a day to day functioning, products,

services, rules and regulations are termed as Induction or orientation training. The purpose of such training is to reduce the nervousness of a new joiner, by making him accustom to the working environment. It is also called as an orientation training, which means giving a fair idea to the new employee about, what he is supposed to do in the organization.

2. **Job Training:** This training is job specific and is given to the employee who has to perform that job. Under this training, the information about the machine, the process of production, methods to be used, the safety measures to be undertaken, etc. are explained. Through this training, the employee develops the confidence and the necessary skills, that enables him to perform his job effectively and efficiently.
3. **Safety Training:** The safety training is given to the employees so as to minimize the number of accidents caused due to the handling of machines or other equipment. Under this training, the employees are given the safety instructions on the usage of machinery and the other dangerous devices.
4. **Apprenticeship Training:** Under this training, the worker earns while learning. This training is generally given to the technical staff, craftsmen, plumber, etc. who are required to work under the superior for a relatively longer period, until he gains the expertise in that particular field.
5. **Internship Training:** Under this type, the educational or vocational institutes have an arrangement with the industrial institutes to provide practical knowledge to its students. Sometimes, the companies also offer the pre-placement offers to the trainees on the basis of their performance during their internship program.
6. **Refresher Training or Retraining:** As the name implies, the retraining or refresher training is given to the old employees with the purpose of improving their efficiencies. They are introduced to the new methods and technologies that would result in the increased productivity and reduces the monotony in their daily work.
7. **Promotional Training:** This training is given to the potential employees, who can be promoted to the senior position in the organization. The promotional training is given in advance so that employee gets accustomed to the new roles and responsibilities and do not get nervous at the time of promotion.
8. **Remedial Training:** This training is given in order to overcome the shortcomings in the behavior and performance of old employees. Due to the invention of technology, the employees may resist to accept the change and cause a disturbance in the organization. Therefore, such training is given to make them understand the

importance of change and its necessity in the operations of business. This training is generally given by the psychological expert.

Thus, different kinds of training are imparted to the employees depending on their job position and the skills required to perform a particular kind of a task.

On-the-Job Training

The **On-the-Job Training** is a technique wherein the workers, i.e., operative staff, is given the direct instructions to perform their jobs on the actual work floor. The workers can learn the skills that are required to be performed in the actual work conditions and also gets accustomed to the working environment. Also, the organizations need not to bear any additional cost of setting up a classroom or a simulated setup for imparting training to the workers, away from the actual work floor, as in the case of Off-the -Job training.

1. **Coaching:** Under this method, the superior or an experienced staff gives instructions to the workers to perform a job. It is one-to-one training designed for the workers where they can find answers to their queries through the instructions and demonstrations given by the superior.
2. **Mentoring:** This training is given to the managerial level people, wherein the senior or the manager gives instructions to the immediate subordinate to carry out the day to day functioning. It is again a one-to-one training method, where the manager is considered as a mentor to the subordinate and guides him in the situations of difficulty.
3. **Job Rotation:** Under the job rotation, an employee is often shifted to the other related jobs, with the intention to make him well versed with other job backgrounds. This helps him to escape the boredom caused by performing the same kind of work again and again and also helps in developing a rapport with other people in the organization.
4. **Job Instructional Training:** Under this training, a trainer designs a step by step training program, wherein the worker is given the instructions to perform the job as required. Firstly, the overview of the job along with the desired results is explained to the trainee, and then the skills required for the job is demonstrated by the trainer. Then a worker is allowed to perform the job as per his acquired skills or expertise, and then finally the workers are asked to give their feedback and ask for any query arising out of the training program.

5. **Understudy:** Here, the superior gives training to the subordinate as an understudy or an assistant who is likely to perform a superior's job in case of the vacancy arising out of superior's retirement, transfer, promotion or death.
6. **Apprenticeship:** This type of training is generally given to the people in crafts, trade and technical fields that require a long-term learning before they actually gain the proficiency in their respective disciplines. This training is a blend of classroom and on-the-job training and is conducted under the close supervision. This can be extended up to 3 to 4 years as apprentices need to go through the learning process till they become an expert in their fields. E.g. The craftsmen job, mechanic, electrician, plumber, tool maker, etc. have to undergo this type of training.

On-the-Job training is based on the principle of “**learning by doing**”, i.e. the workers learn the job while performing it within the actual work environment. This type of training is beneficial for both the workers and the organization.

Off-the-Job Training

The **Off-the-Job Training** is the training method wherein the workers/employees learn their job roles away from the actual work floor.

Simply, off-the-job training comprises of a place specifically allotted for the training purpose that may be near to the actual workplace, where the workers are required to learn the skills and get well equipped with the tools and techniques that are to be used at the actual work floor.

1. **Special lectures:** This is also called as classroom training wherein the employees are given lectures about the job requirements and the necessary skills required for implementing the job. There is generally a classroom or a workshop wherein the complete job knowledge is given to the workers by the experts or specialists from the professional institutes. The main purpose of this training is to make the employees well informed about their job roles and discussing their queries arising out of the lectures.
2. **Simulation:** Under this training, the trainee is required to learn the operations of machines and equipment, that are reasonably designed to look similar to those installed at the actual work floor. This is one of the most common method of

training wherein the worker learns to operate tools and machinery that look alike to those, they would be using in the actual work environment.

3. **Vestibule Training:** This type of training is specifically given to the technical staff, office staff and the employees who learn the operations of tools and equipment assembled at a place away from the actual work floor. This type of training is conducted to give the real feel to the trainees, that they would be experiencing at the actual plant.
4. **Case Studies:** Under this method, the trainees are given the situation or a problem in the form of a case study, and are required to solve it as per their learning from the training program.
5. **Role playing:** This type of training is essential in case of customer services. Under this, the trainees assume roles and enact as per the given situations. It is also called as *socio-drama or psycho-drama*, wherein the employees act as if, they are facing the situation and have to solve it spontaneously without any guidance.
6. **Management Games:** Under this method, the trainees are divided into groups and then they are presented with the simulated marketplace or the situations, wherein they are required to apply their learning and solve the problems accordingly.

Under off-the-job training, the worker concentrates only on the learning of a job and is not accountable for the production.

SUCCESSION PLANNING

Definition: Succession Planning is defined as the systematic process of **recognizing and creating future leaders** who are able to take the position of the old ones when they leave the organization due to retirement, resignation, termination, transfer, promotion or death.

In finer terms, it is a modern technique followed by many companies, that concentrates on identifying the prospects, out of many employees in the organisation, who might be possible successors, for the key positions.

Need for Succession Planning

Succession Planning is a part and parcel of the Human Resource Planning, which acknowledges that the employees may or may not work with the organization in the future.

And so to be at the safer side, a succession plan is developed to analyse the vacancies which might take place when an employee leaves the organization, the business areas which might be affected, job requirements and the skills of the existing incumbent.

Hence, there is a need for strategic planning, to determine where and how viable employees can fill the vacant positions.

Process of Succession Planning

1. **Identifying Key Business Areas and Positions:** First and foremost, the key business areas are identified, i.e. the areas which are significant with respect to the operational activities and strategic objectives. After that, those positions are identified which if vacant can cause difficulty in achieving business objectives.
2. **Ascertaining Competencies for Key areas and positions:** Next, you need to determine the required competencies for key business areas and position, in order to create the selection criteria, establish performance standards and fill the difference between what the viable successors know and what they need to know, through the training and development process. It determines the knowledge, skills, ability and experience required to achieve business goals.
3. **Find out the interested and potential candidates and assess them as per the competencies:** After competency is analysed, the next step is to identify among various employees working in the organization, who are interested as well as they have the capability to fill key business areas and positions. The Human Resource Manager discusses future career plans and interests with the candidates and identifies the potential successors who are ready to replace the old ones and can be trained and developed for future contingencies.
4. **Develop and Implement Succession Strategies:** Strategies for learning, training, development, knowledge transfer, experience sharing is developed and implemented for potential successors.
5. **Evaluate Effectiveness:** The last step to the succession planning process is to evaluate the succession planning and management, to ensure that all the key business areas and positions are covered under the succession planning. Further, it also ensures that in case of any sudden vacancies in future, key positions can be filled as soon as possible and the successors perform effectively when they hold the position.

Therefore, **Succession Planning is all about developing a leadership substitute**, for a perpetual succession of the organization without any kind of disturbance, when there are changes in the top management.

An ideal Succession Planning is one that involves the participation of the top management, a thorough review of the plan developed, evaluation of the performance and capability of the candidates and each candidate is provided with the written development plan.

It is a rational decision of the management to promote the regular development of the workforce, to make sure that the top managerial positions have some sort of stability, thus ensuring an organization to attain its ultimate objectives.

Theories of Compensation

The **Compensation** is the remuneration given to the employees for the work they do for the organization. In other words, an employee is entitled to both the financial and the nonfinancial benefits in return for his contribution to the organization.

To understand which component of compensation is efficient, we need to go through the theories of compensation. There are three theories of compensation viz. Reinforcement and Expectancy Theory, Equity Theory and Agency theory which are explained below.

1. **Reinforcement and Expectancy Theory:** This theory is based on the assumption that, the reward-earning behavior is likely to be repeated, i.e. an employee would do the same thing again for which he was acknowledged once. Similarly, in the case of Expectancy Theory, given by Vroom, the employee is motivated to do a particular thing for which he is sure or is expected that performance will be followed by a definite reward or an outcome.
2. **Equity Theory:** According to this theory, there should be equity or the uniformity in the pay structure of an employee's remuneration. If the employee feels he is not being paid fairly for the amount of work he does in a day will result in lower productivity, increased turnover and high absenteeism. The remuneration system should comply with three types of equity:

2.1 **Internal Equity:** The employee perceives the fairness in different pay for different jobs based on the nature of work involved, i.e. he must feel that pay differentials among the jobs are fair.

2.2 **External Equity:** The employee should feel the fairness in what they are being paid is in line with what other players in the same industry are paying to their employees for the same kind of job.

2.3: **Individual Equity:** The employee perceives the pay differentials among the individuals who are performing the same kind of a job and within the same organization. Usually, an individual with more experience gets high remuneration as compared to the fresher irrespective of the nature of a job.

3. **Agency Theory:** This theory states that both the employer and the employee are the stakeholders of the company, and the remuneration paid to the employee is the agency cost. The employee will try to get an increased agency cost whereas the employer will try to minimize it. Hence, the remuneration should be decided in such a way that the interest of both the parties can be aligned.

Thus, these theories posit that the compensation in the form of salary or wages can be decided on the basis of the outcome or the behavior of an employee.

Factors Affecting Employee Compensation

The **Compensation** is the monetary and non-monetary rewards given to the employees in return for their work done for the organization. Basically, the compensation is in the form of salaries and wages. There are several internal and external factors affecting employee compensation, which are discussed in detail below.

Internal factors: The internal factors exist within the organization and influences the pay structure of the company. These are as follows:

1. **Ability to Pay:** The prosperous or big companies can pay higher compensation as compared to the competing firms whereas the smaller companies can afford to maintain their pay scale up to the level of competing firm or sometimes even below the industry standards.

2. **Business Strategy:** The organization's strategy also influences the employee compensation. In case the company wants the skilled workers, so as to outshine the competitor, will offer more pay as compared to the others. Whereas, if the company wants to go smooth and is managing with the available workers, will give relatively less pay or equivalent to what others are paying.
3. **Job Evaluation and Performance Appraisal:** The job evaluation helps to have a satisfactory differential pays for the different jobs. The performance Appraisal helps an employee to earn extra on the basis of his performance.
4. **Employee:** The employee or a worker himself influences the compensation in one of the following ways.
 - *Performance:* The better performance fetches more pay to the employee, and thus with the increased compensation, they get motivated and perform their job more efficiently.
 - *Experience:* As the employee devote his years in the organization, expects to get an increased pay for his experience.
 - *Potential:* The potential is worthless if it gets unnoticed. Therefore, companies do pay extra to the employees having better potential as compared to others.

External Factors: The factors that exist out of the organization but do affect the employee compensation in one or the other way. These factors are as follows:

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1. **Labour Market:** The demand for and supply of labour also influences the employee compensation. The low wage is given, in case, the demand is less than the supply of labour. On the other hand, high pay is fixed, in case, the demand is more than the supply of labour.
2. **Going Rate:** The compensation is decided on the basis of the rate that is prevailing in the industry, i.e. the amount the other firms are paying for the same kind of work.
3. **Productivity:** The compensation increases with the increase in the production. Thus, to earn more, the workers need to work on their efficiencies, that can be improved by way of factors which are beyond their control. The introduction of new technology, new methods, better management techniques are some of the factors that may result in the better employee performance, thereby resulting in the enhanced productivity.

4. **Cost of Living:** The cost of living index also influences the employee compensation, in a way, that with the increase or fall in the general price level and the consumer price index, the wage or salary is to be varied accordingly.
5. **Labour Unions:** The powerful labour unions influence the compensation plan of the company. The labour unions are generally formed in the case, where the demand is more, and the labour supply is less or are involved in the dangerous work and, therefore, demands more money for endangering their lives. The non-unionized companies or factories enjoy more freedom with respect to the fixation of the compensation plan.
6. **Labour laws:** There are several laws passed by the Government to safeguard the workers from the exploitation of employers. The *payment of wages Act 1936*, The *Minimum wages act 1948*, The *payment of Bonus Act 1965*, *Equal Remuneration Act 1976*, *Payment of Gratuity Act 1972* are some of the acts passed in the welfare of the labour, and all the employers must abide by these.

Thus, there are several internal and external factors that decide the amount of compensation to be given to the workers for the amount of work done by them.

Methods of Wage Payment

Definition: A Wage is a monetary compensation given by the employer to the employee (labour) for the amount of work done on an hourly, weekly or monthly basis.

1. **Minimum Wage Method:** Under this method, the minimum amount of wage is paid to the employee irrespective of the employer's paying ability. It is based on the concept that the wage is paid not for the bare sustenance of life, but for the preservation of the efficiency of the worker. Thus, the minimum wage must provide for education, medical requirements, and other essential amenities.
2. **Fair Wage Method:** The wage is said to be a fair wage when its amount is similar to the rate that prevails in the same industry in the neighborhood or the rate that prevails throughout the country for the same kind of work. A standard rate is maintained for the wage that prevails in the other similar industries, and this rate is determined by the companies where exists an unionized labour and is in large numbers.
3. **Living Wage Method:** The living wage is slightly higher than the fair wage, in which the worker not only fulfill his basic needs of life viz. food, clothing and shelter, but

also avail the frugal comforts such as education of children, insurance, protection against ill health, essential social needs, etc. The rate of the living wage is determined on the basis of economic condition prevailing in the country. Therefore, these wage rates may differ from country to country.

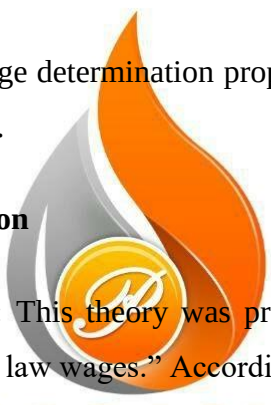
Thus, the employers follow different methods of wage payment depending on their paying capacity and the economic conditions prevailing in the country.

Theories of Wage Determination

The workers are paid wages or salaries for the work done by them. Thus, the return to the workers should be according to their efforts and the pay standards prevailing in the industry.

There are several theories of wage determination propounded by different scientists and are based on varied assumptions.

Theories of Wage Determination

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1. **Subsistence Wage Theory:** This theory was propounded by **David Ricardo** and called this theory as an “iron law wages.” According to this theory, the labour is paid the minimum amount of wage that is sufficient to subsist and perpetuate their race without either increase or decrease. It is based on the assumption that the law of diminishing returns applies to the industry, and the population tends to increase. If the labour is paid below the subsistence level, they will die out of malnutrition, disease or hunger and therefore, the number of workers gets reduced. On the other hand, if the wage increases above the subsistence level, the number of workers will get attracted to procreate and thus, with the increase in labours the wage rate comes down. Thus, there is a subsistence level, which is maintained and is not either increased or decreased.
2. **Wage Fund Theory:** This theory was developed by **Adam Smith**, and is based on the assumption that the wage is paid out of the pre-determined wealth or fund, which lays surplus with the wealthy persons, as a result of savings. The amount of wage to be paid to the worker depends on the size of the fund. Larger the fund, more labour would be employed and given higher wages, whereas in the case of less funds, the

wage would reduce to the subsistence level. This theory was further expounded by **J.S.Mill**, and according to him the wage fund is fixed, and the wages can be determined on the basis of demand for and supply of labour. And thus, the fund size decides the demand for the labour. To have an increased wage, the number of labour is to be reduced, and the fund is to be enlarged.

3. **Surplus Value Theory:** This theory is given by **Karl Marx**, and according to him, like other articles, labour is also an article of commerce and could be purchased by paying a subsistence price. The price of a product is determined by the amount of time; a labour devotes for its production. And the proportion of time spent by the labour on work is much less and, therefore, paid a minimum price and the surplus amount is utilized for the other expenses.
4. **Residual Claimant Theory:** **Francis. A Walker** propounded this theory, and according to him there four factors of production viz. Land, labour, capital and entrepreneurship. The wage is the amount given in return for the amount of production and thus is paid after the payment of all other factors. Thus, the wage is considered to be a residual claimant, and is computed as: **Wage= Whole production-(Rent+ Interest+ Profit)**
5. **Marginal Productivity Theory:** This theory is given by **Phillips Henry Wicksteed and John Bates Clark**, and it is based on the assumption that wage is determined on the basis of last worker's contribution in the production i.e. the marginal production. This theory assumes that wage depends on demand for and supply of labour. As far as, the marginal productivity is equal to the wages paid, a firm will continue employing more labour.
6. **Bargaining Theory:** **John Davidson** has given this theory, and according to him, the wages are determined on the basis of a bargaining capacity of workers or their unions and employers. If the trade union is stronger, then the wages will be high, and if the employer is powerful, the wages tend to be low.
7. **Behavioral Theory:** Several behavioral scientists (viz. **March and Simon, Robert Dubin, Eliot Jacques,**) have presented their research on the wage determination. According to them, there are various factors such as employer's concern for the workers, the strength of unions, size and prestige of company, etc. that determines the amount of wage to be disbursed among the workers.

Thus, the firm can adopt either of the wage methods depending on the nature of a job and the worker's contribution towards the accomplishment of a work.

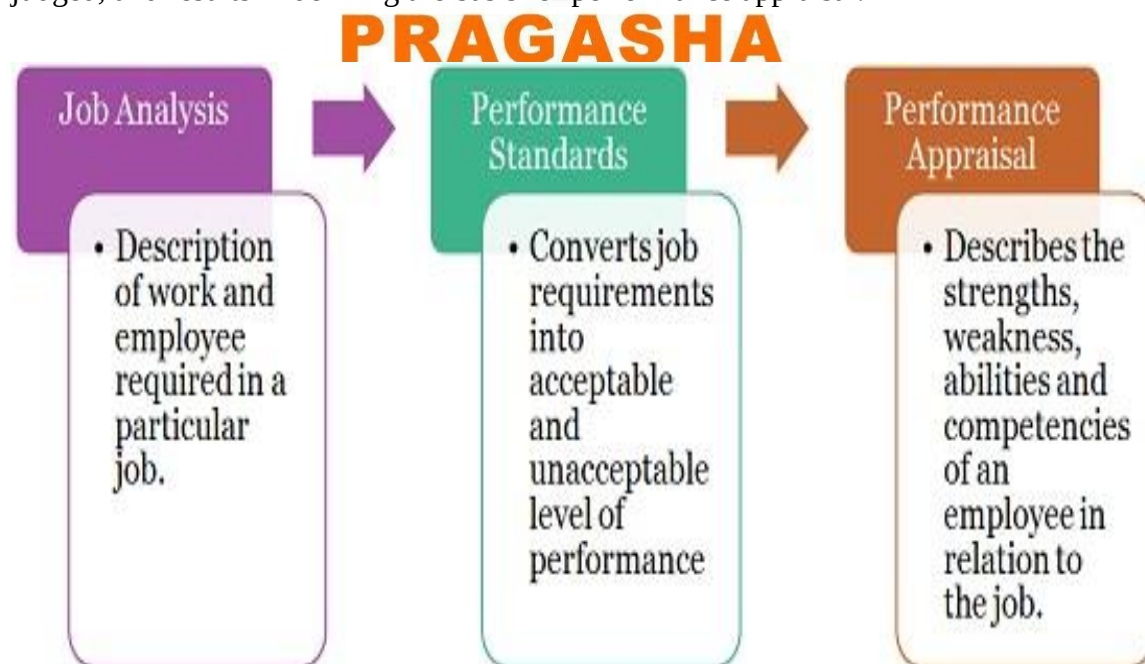
PERFORMANCE APPRAISAL

Performance Appraisal is defined as a systematic process, in which the personality and performance of an employee is assessed by the supervisor or manager, against predefined standards, such as knowledge of the job, quality and quantity of output, leadership abilities, attitude towards work, attendance, cooperation, judgment, versatility, health, initiative and so forth. It is also known as performance rating, performance evaluation, employee assessment, performance review, merit rating, etc.

Performance Appraisal is carried out to identify the abilities and competencies of an employee for future growth and development. It is aimed at ascertaining the worth of the employee to the organization, in which he/she works.

Relationship of Performance Appraisal and Job Analysis

Performance Appraisal relates to job analysis, in the sense that job analysis establishes job requirement, which converts the analysis into standard, on which performance is judged, and results in defining the basis for performance appraisal.



Objectives of Performance Appraisal

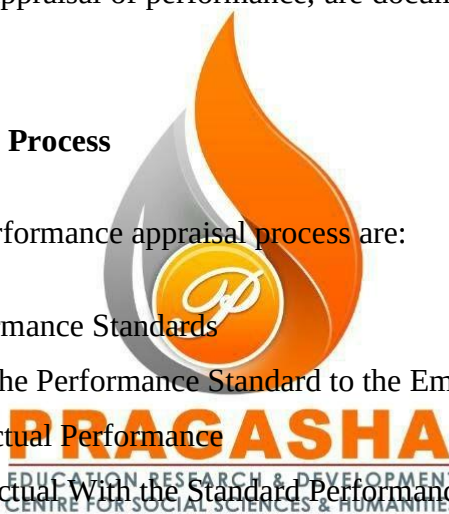
- To promote the employees, on the basis of performance and competence.
- To identify the requirement for training and development of employees.
- To provide confirmation to those employees who are hired as probationary employees, upon completion of the term.
- To take a decision regarding the hike in employees pay, incentives etc.
- To facilitate communication between superior and subordinate.
- To help employees in understanding where they stand in terms of performance.

Data obtained from the appraisal of performance, are documented and used for different organizational purposes.

Performance Appraisal Process

The steps involved in performance appraisal process are:

1. Setting the Performance Standards
2. Communicating the Performance Standard to the Employees
3. Measuring the Actual Performance
4. Comparing the Actual With the Standard Performance
5. Providing Feedback
6. Initiating Corrective Actions.



Method of Performance Appraisal

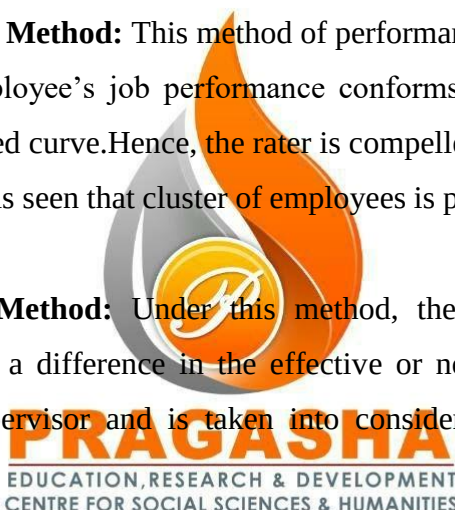
In the process of designing performance appraisal process, it is important to identify the best method for assessment. There are a number of methods introduced to gauge the quantity and quality of work performed by an individual. These methods are broadly classified into two categories:

Traditional Methods of Performance Appraisal)

1. **Rating Scales:** The numerical scale is prepared that represents the job evaluation criterion such as the output, initiative, attendance, attitude, dependability, etc. and

ranges from excellent to poor. Thus, each employee is given the rating based on his performance against each set criteria and then the consolidated score is computed accordingly. The rating scales are one of the easiest traditional methods of performance appraisal and can be applied to any job.

2. **Checklist:** A checklist of employee traits in the form of statement is prepared where the rater put a tick mark in “Yes” or “No” column against the trait checked for each employee. Once the checklist gets completed the rater forwards the list to the HR department for the final evaluation of the employee.
3. **Forced Choice Method:** Under this method, the rater is forced to answer the ready-made statements as given in the blocks of two or more, about the employees in terms of true or false. Once he is done with the list, it is forwarded to the HR department for the final assessment of the employee.
4. **Forced Distribution Method:** This method of performance appraisal is based on the assumption that employee’s job performance conforms to the normal distribution curve i.e. a bell shaped curve. Hence, the rater is compelled to put employees on each point on the scale. It is seen that cluster of employees is placed at the highest point on a rating scale.
5. **Critical Incidents Method:** Under this method, the critical behavior of each employee that make a difference in the effective or non-effective performance is recorded by the supervisor and is taken into consideration while evaluating his performance.
6. **Behaviorally Anchored Rating Scale:** The descriptive statements about employees’ behavior, both effective and ineffective are put on the scale points, and the rater is asked to indicate which behavioral point describes the employee behavior the best.
7. **Field Review Method:** Under this method, the performance evaluation of an employee is done by someone who does not belong to his department or is usually from the corporate office or the HR department. The outsider reviews the performance of an employee through his records and holds interviews with the assessee and his superiors.
8. **Performance Tests and Observations:** The test either written or oral is conducted to test the knowledge and the skills of employees. Sometimes the employee is asked to demonstrate his skills in the given situation and then he is evaluated on that basis.



9. **Confidential Reports:** The confidential reports are mostly prepared by the government departments, wherein the employee is evaluated on some of the following parameters:

- Attendance
- Leadership
- Self-expression
- Ability to work with others
- Initiative
- Technical ability
- Integrity
- Responsibility, etc.

10. **Essay Method:** Under this method, the detailed description of the employee performance is written by the rater. The performance of an employee, his relations with other Co-workers, requirements of training and development programs, strengths and weaknesses of the employee, etc. are some of the points that are included in the essay. The efficiency of this traditional method of performance appraisal depends on the writing skills of the rater.

11. **Cost Accounting Method:** In this method, the employee's performance is evaluated in monetary terms, i.e. how much cost company is incurring on keeping the employee and how much he is contributing to the firm in terms of his output.

12. **Comparative Evaluation Approaches:** Under this method, several comparative analysis are done, wherein the performance of one employee is compared with that of another Co-worker, and the rating is determined accordingly. The Ranking Method and the Paired Comparison Method are the usual comparative forms used in this approach.

- Ranking Method:** In the Ranking Method, superiors give the rank from best to worst, to their subordinates on the basis of their merits. Here, the detailed description of why best or why the worst is not given.
- Paired Comparison Method:** Under this method, the performance of each employee is compared with the other employee and then the decision on whose performance is better is made.

Thus, the performance of an individual can be evaluated using either of the methods that best measures the behaviour of an employee and gives the exact evaluation of worker's doings.

Modern Methods of Performance Appraisal)

1. **Management by Objectives:** This concept was given by Peter.F.Drucker, according to him, the performance of an employee can be assessed on the basis of the targets achieved by him as set by the management of an organization. Firstly, the management sets the goals and communicate the same to the employees, and then the performance of an employee is compared against these set goals and is evaluated on this basis. In case the employee is not able to achieve the pre-established goals, then management decides on a new strategy or policy that should be undertaken for the accomplishment of unattainable goals.
2. **Psychological Appraisals:** This is one of the most frequently used modern methods of performance appraisal, wherein the psychologist assesses the employee's potential for the future performance rather than the past one. Under this method, the psychologist conducts the in-depth interviews, psychological tests, discussions with the supervisors and the reviews of other evaluations. This assessment is done to determine the intellectual, emotional, motivational and other related characteristics of an employee that is necessary to predict his potential for the future performance.
3. **Assessment Centres:** The assessment center is the central location where the managers come and perform the job exercises. Here the assessee is requested to participate in in-basket exercises, role playing, discussions, computer simulations, etc. Where they are evaluated in term of their persuasive ability, communication skills, confidence, sensitivity to the feelings of others, mental alertness, administrative ability, etc. This entire exercise is done under the trainer who observes the employee behavior and then discusses it with the rater who finally evaluates the employee's performance.
4. **360-Degree Feedback:** It is a feedback method wherein the details of an employee's performance is gathered from other stakeholders such as superiors, peers, team members and self. In this method, the employee is asked about himself, i.e. what he feels about his performance, and then accordingly he can realize his strengths and weaknesses. Also, the peers or team members are asked about assessee's performance

through which the employee knows about what others feel about him and can overcome his disbeliefs if any. Thus, this method is used to have a detailed evaluation of an employee from all the perspectives.

5. **720-Degree Feedback:** This is an another feedback method, wherein the assessment is done not only by the stakeholders within the company but also from the groups outside the organization. These external groups who assesses the employee's performance are customers, investors, suppliers and other financial institutions. It is one of the most crucial modern methods of performance appraisal because this is the only group that determines the success of the organization as a whole.

Nowadays, companies use the modern methods of performance appraisal which have a broader scope than the traditional methods and provides a more accurate and comprehensive evaluation of an individual.

Performance Appraisal is a part of **performance management**. It helps in gaining the competitive edge, by improving the performance level of the employees working in the organization, making rational decisions regarding hike in salaries, promotions, transfers, discharge of the employees, reducing job dissatisfaction and employee turnover.

WAGE INCENTIVE PLANS: OBJECTIVES, ADVANTAGES, LIMITATIONS AND TYPES



Wage incentive refers to performance linked compensation paid to improve motivation and productivity. It is the monetary inducements offered to employees to make them perform beyond the acceptance standards.

According to the National Commission of Labour “wage incentives are extra financial motivation. They are designed to stimulate human effort by rewarding the person over and above the time rated remuneration, for improvements in the present or targeted results”.

Scott defines it as “any formal and announced programme under which the income of an individual, a small group, a plant work force or all the employees of a firm are partially or wholly related to some measure of productivity output”.

Human and Nickerson define it in simple terms as “all the plans that provide extra pay for extra performance in addition to regular wages for a job”.

Objectives of Wage Incentive Schemes:

- i. To use wage incentives as a useful tool for securing a better utilisation of manpower, better productivity scheduling and performance control, and a more effective personnel policy.
- ii. To improve the profit of a firm through a reduction in the unit costs of labour and materials or both.
- iii. To increase a worker’s earning without dragging the firm into a higher wage rate structure regardless of productivity.
- iv. To avoid additional capital investment for the expansions of production capacity.

Principles of a Good Wage and Salary Administration:

- a. Simple and easy to understand.
- b. Union management agreement.
- c. Time standard must be fixed.
- d. Reward must be proportional to the effort.
- e. Complaints and grievances must be properly attended to.
- f. The plans should not change frequently and must be tried out continuously for some length of time.
- g. Equity and fairness.
- h. Workers must be made to understand the plan.
- i. Method study must precede time standard.
- j. There must be a min guaranteed payment.

Advantages of Incisive Plans:

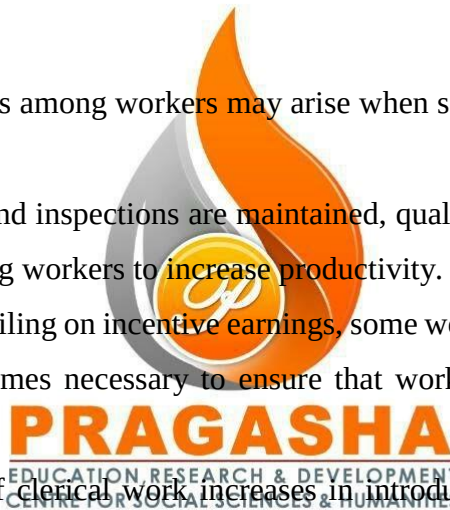
Wage incentive plans benefit not only the employees but also the employers.

- a. Wage incentive plans provide an opportunity for hardworking and ambitious workers to earn more.
- b. It encourages employees to be innovative. They come out with more efficient ways of doing work by overcoming the problems related to productivity and wasteful practice.

- c. Incentive plans help to improve discipline and industrial relations. Effective incentive plan helps in minimizing absenteeism, accidents etc.
- d. The self motivation on the part of the workers to work hard and improve performance so as to earn monetary rewards will reduce the cost of supervision.
- e. The scientific work study undertaken before introducing the incentive plans helps in improving work flow, work methods etc.
- f. The employees are encouraged to work as a team with mutual co-operation as their activities is interdependent, and any obstruction on the part of a worker can affect the output and rewards.
- g. According to the National Commission on Labour, “wage incentive is the cheapest, quickest and surest means of increasing productivity.”

Limitations:

- a. Jealousy and conflicts among workers may arise when some workers earn more than others.
- b. Unless strict check and inspections are maintained, quality may come under stake in the enthusiasm among workers to increase productivity.
- c. In the absence of a ceiling on incentive earnings, some workers may spoil their health.
- d. Strict vigilance becomes necessary to ensure that workers do not disregard safety regulation.
- e. The cost and time of clerical work increases in introducing and administering the incentive plans.
- f. Whenever production flow is disrupted due to the fault of management, workers insist on compensation.



Types of Wage Incentive Plans:

Following are the types of wage incentive plans.

They can be diagrammatically represented as below:

1. Straight Piece Rate Plan:

Under the straight piece rate plan workers are paid based on their output. For example, if the piece rate is Rs. 4 per piece of the product, then a worker who turns out 40 pieces/day

earns Rs. 160 (Rs. 4 x 40) as his wage for that day. Whereas another employee who produces 32 pieces/ day earns Rs. 128 (Rs. 4 x 32 pieces). Hence a fast worker earns more compared to the slow worker.

Advantages:

- i. Motivates the workers to increase their output.
- ii. Simple and easy to understand.
- iii. Improve productivity.

Disadvantages:

- i. No guaranteed minimum wage. This makes workers insecure.
- ii. Great disparity of earning between slow and fast workers.
- iii. Wastage might increase.
- iv. Quality of production may suffer as the workers concentrate on quantity.
- v. Interpersonal relationship suffers due to jealousy and competition to earn more.
- vi. Enforced idleness like electricity failure or machine breakdown, adversely affect earning of workers.

2. Standard Piece Rate with Guaranteed Minimum Wage:



Here the minimum guaranteed wage is fixed on hourly basis. A worker gets the minimum fixed wage/day plus the incentive for the number of pieces produced. To illustrate this, assume that there is 8 hour's shift the piece rate is Rs 4 and a minimum fixed wage of Rs 16/ hours (Rs 16 x 8 hours = Rs. 128 per day). The standard time/piece is 15 min.

Now, there are two workers A and B. (If worker A produces 25 prices/day then he earns: Rs. 128 (min. guaranteed wage) + Rs. 100 (Rs. 4 x 25 pcs) = Rs. 228/ day

If worker B produces 40 pieces / day then he earns Rs. 128 (min. guaranteed wage) + Rs. 160 (40 pieces x Rs. 4) = Rs. 288/ day)

Advantages:

- i. Min. guarantee improves sense of security.
- ii. Disparity between slow and faster workers is reduced.

Disadvantages:

- i. Demotivate faster worker.
- ii. Slow workers get higher piece rate viz Rs. 5.12 (128/ 25).

Differential Piece Rates:

The shortcoming of the above mentioned incentive plans have given way Differential piece rates. The differential piece rates are classified under two heads viz. Individual incentive plans and Group incentive plans.

Individual Incentive Plans:

The different plans here are discussed below:

(a) Halsey Plan:

The features of this plan are:

- a. Min. wage is guaranteed.
- b. Additional bonus is provided to workers who Wage and Salary Administration 147 complete the job in less than the “standard time”. Bonus is a certain proportion to the time saved. This proportion is fixed at 50% in this plan.



The total wage is calculated as:

$$T \times R + 50\% (S - J) \times R$$

Where J – time taken

R – Rate of wage

S – Standard time

50% – The bonus percentage.

Advantages:

- i. Guaranteed min. wage exists.

- ii. Simple and easy.
- iii. Dispensed with time consuming and costly process of work study.
- iv. Management share a part of bonus on time saved.

Disadvantages:

- i. Workers get only half of the benefit of their efficiency.
- ii. If the worker's rush through the job to save time, the quality may suffer.
- iii. Workers object management in sharing bonus on time saved.
- iv. Sufficient incentive is not provided to fast workers.

(b) Rowan Plan:

This is a modified form of Hasley Plan, developed by James Rowen of England. The Rowan Plan pays more than the Halsey Plan. This is possible if a worker completes the task in half the standard time of the task. If more than 50% time is saved then the bonus he earns decreases.

Therefore, Total wage = $J \times R + [J \times R \times (\text{Time saved}/\text{std. time})]$

Advantages:

- i. Minimum guaranteed wage exists.
- ii. Both the employees and the workers share the benefits of time saved.
- iii. The efficient workers get bonus at diminishing rate if they save more than 50% of the standard time. This checks over-speeding.

Disadvantages:

- i. Incentive provided for fast worker is not sufficient.
- ii. Workers dislike management sharing bonus of time saved.

(c) Gantt plan:

This plan was developed by Henry L. Gantt. Here standard time for every task is fixed through time and motion study. Minimum time wage is guaranteed to all workers.



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A worker who fails to complete the task within the standard time receives wages for actual time spent at the specified rate. Workers who achieve or exceed the standard get extra bonus varying between 20% to 50% of the hourly rate for the time allowed for the task.

Advantages:

- i. Minimum guarantee exists.
- ii. Fast worker is paid bonus at higher rate proportional to their output.
- iii. Standard worker is paid 20% bonus.
- iv. Part of bonus is shared by the organisation.

Disadvantages:

- i. Sharing of bonus by organisation is resentment.
- ii. Disunity among the slow and the fast workers.

(d) Bedeaux Plan:

This plan is developed by Charles E. Bedeaux in 1911. Here the minimum time wage is guaranteed to all workers. The workers who complete the job within or more than the standard time are paid at the normal time rate.

Workers who complete the job in less than the standard time are paid bonus, generally 75% of the wage for the time saved and 25% to the foreman.

The wage rate is calculated as:

$$S \times R + 75\% \text{ of } R (S - T)$$

$$\Phi = \text{Rs. } 57.50$$

Advantages:

- i. Min. wage is guaranteed to all the workers.
- ii. The foreman is motivated to the productivity as 25% of time saved is paid to him.
- iii. This plan is suitable in factories wherein a worker is expected to perform different types of jobs.

Disadvantages:

- i. Workers may resent sharing the bonus with foreman.
- ii. Workers may find it difficult to understand the complete calculation involved in this method.

(e) Emerson's Efficiency Plan:

This plan was developed by Harrington Emerson. Here minimum wage is guaranteed. Workers are paid different bonus rates as per their efficiency level. Bonus is given at an increasing percentage beyond the prescribed level of efficiency (usually 66.67%). Efficiency is measured by comparing the actual time taken with the standard time.

Advantages:

- i. Guaranteed time wage provides a sense of security to all the workers.
- ii. It encourages healthy competition among workers.
- iii. Bonus begins at 66.67% efficiency which is within the reach of many workers.

Disadvantages:

- i. There is little incentive after 100% efficiency level.
- ii. The plan is not very flexible or selective.
- iii. Employer may fix the standard time at a low level making it impossible for most of the workers to earn bonus.

**Group Incentive Plan:**

In some cases like an assembly line production it is not possible to determine the performance of an individual worker as several workers jointly perform a single operation. In such cases it is desirable to introduce a group incentive scheme. Here the bonus is calculated for a group of workers and the total amount is distributed among the group members in proportion to the wage earned by each.

(a) The Scalar Plan: This is a group plan where the productivity of the entire work force is taken into account. In this plan bonus is paid at the rate of 1 % for every 1% rise in

productivity. Workers are not paid the full amount of bonus earned by them in the same month.

A certain percentage is set aside as a “Resource Fund” to take care of fluctuation. At the end of the year, the balance remaining in the “Reserve Fund” is also distributed.

(b) Priest Man Bonus Plan: Here a committee of workers and management set the standard of performance. A minimum wage is guaranteed to each worker. The group gets bonus when actual output exceeds the standard. The group supervisor also gets a share on the group bonus. This plan promotes team spirit among employees.

Other Forms of Incentives:

Apart from the above mentioned incentive plans; there are also other forms of incentives, especially for the white collared workers. They are briefly discussed below.

Employee Stock Option Plan:

This is popularly known as ESOP. This is a form of incentive where the employees are allotted the company share at a price below the market price. When the company achieve better results, the market price of its shares and the value of the employees’ shareholding rise.



This form of incentive plan is relatively new in India and is becoming popular of late. IT is motivating to the employee, as (it enhances a sense of belongingness to the organisation) shareholders are the owners of the organisation.

Profit Sharing:

Prof. Seager defines profit sharing as “an arrangement by which employees receive a share, fixed in advance of the profits”. Profit sharing usually involves the determination of an organisation profits at the end of the fiscal, year and the distribution of a percentage of the profits to the workers qualified to share in the earnings. The main objectives of profits sharing are to create unity of interest and the spirit of co-operation.

The theory behind profit sharing is that management should feel its workers will fulfill their responsibilities more diligently if they realize that their efforts may result in higher profits which will be returned to the workers through profit sharing.

In India this incentive scheme is not well received by both the management and the workers. Committee appointed by the Govt. of India suggested profit sharing as a method of ensuring industrial peace and a step towards workers' participation in management and also suggested that 50% of the profit be shared among the workers.

Both the employers and the trade unions rejected this. The trade unions prefer bonus to profits sharing as bonus is payable irrespective of profit or loss under the Bonus Act 1965.

FRINGE BENEFITS:

ILO describes fringe benefits as wages are often augmented by special cash benefits, by the provision of medical and other services or by payment in kind that form part of the cost for expenditure on the goods in services. In addition workers commonly receive such benefits as holidays with pay low cost meals, low rent housing etc. such additions to the wage proper are sometimes referred to as fringe benefits.

Fringe benefits involve a labour cost for the employer and are not meant directly to improve efficiency. These add to the workers standard of living. Hence benefits may be statutory or voluntary. They improve motivation and morale of workers by satisfying their needs and develops a sense of belonging and loyalty among workers. They also improve the public image of the organisation.

THE CONCEPT OF MORALE

Morale is the term usually applied to armed forces during wartime and to sports and athletic teams. It refers to team spirit and co-operation of people for a common purpose. Its importance has been realised by the management only in recent years. It is felt by the management that if the morale of the employees is high, production would be higher and vice-versa.

Meaning: Morale represents the attitudes of individuals and groups in an organisation towards their work environment. Morale is an indicator of the attitude of employees

towards their jobs, superiors and their organisational environment. It is a collection of the employees' attitude, feelings and sentiments.

Definition:

- According to William Spriegel, **“morale is the co-operative attitude or mental health of a number of people who are related to each other on some basis”**.
- According to Leighton, **“morale is the capacity of a group of people to pull together persistently and consistently in pursuit of a common purpose”**.

Characteristics of Morale:

- i. Morale is basically a psychological concept
- ii. Morale is intangible therefore it is very difficult to measure the degree of morale accurately
- iii. Morale is contagious in the sense that people learn from each other
- iv. Morale is dynamic in nature. It cannot be developed overnight. Managers have to make continuous efforts to build and maintain high morale. It is a long-term concept.
- v. Morale is a group phenomenon consisting of a pattern of attitudes. It is the sum total of employees' attitudes, feelings and sentiments.

Significance of Morale:



- Morale is the vital ingredient of organisational success because attitudes and sentiments of employees greatly influence productivity and satisfaction of employees.
- Morale may be high or low; when the morale of the employees is high, they co-operate fully with the management towards the achievement of organisational objectives.
- High morale leads to good discipline, high degree of interest in the job, loyalty to the organisation and high performance.

Consequences of low Morale:

Low morale indicates the presence of mental unrest. This mental tension or unrest not only hampers production and productivity but also leads to ill-health of the working people. The other consequences of low morale are the following:

1. High rate of labour turnover
2. High rate of absenteeism
3. Excessive complaints and grievances
4. Resistance to change
5. Lack of discipline
6. Antagonism towards the organisation and its management
7. Low quantity and quality of output

Low morale can be fatal to the organisation. In order to avoid the evil consequences of low morale, every manager should attempt to build high morale amongst his subordinates.

Steps to build High Morale:

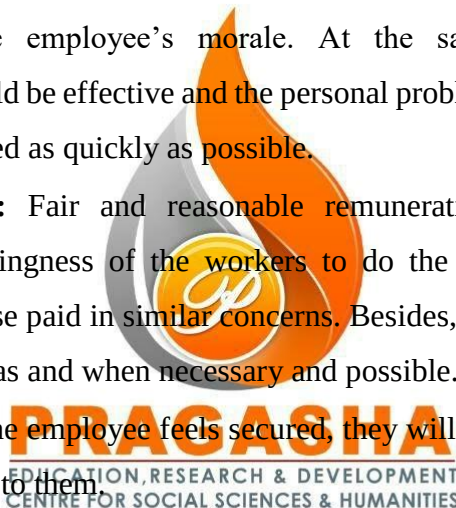
Every manager should attempt to build high morale of his subordinates. Both individual and collective efforts are required to develop and maintain high morale. The following measures are taken to improve the morale of employees in the organisation:-

1. A fair system of wage and salary payments should be evolved
2. A sense of security of job should be ensured
3. The promotion policy should be sound and should be followed promptly
4. Competent supervisors should be appointed
5. The channel of communication should be effective.
6. The employees should be made to feel proud of being employed in the organisation
7. Employees' welfare schemes like housing, medical benefits, education facilities for children, canteen, credit facilities, and safety measures should be provided as they are very helpful in developing positive attitude among the employees.
8. Workers should be given proper training so that they may perform their jobs without frustration and get job satisfaction.

Factors determining morale:

The degree of morale in any organisation is determined by several factors. Some of them are merely psychological and difficult to identify, however researchers have succeeded in figuring out the following factors:

- **Confidence in leadership:** If the leader of the organisation is able to win the confidence of the employees, morale will be high. For employees, the leader being mentioned is the immediate supervisor/superior. If the leader is systematic, fair, honest, helpful and friendly, he may win over the confidence of his subordinates and boost their morale.
- **Job Satisfaction:** The morale of the employee would be high if he is satisfied with his job. Hence right men should be placed in the right job to boost up their morale in their jobs.
- **Confidence in co-workers:** Mani is a social being and he finds himself more enthusiastic in the company of others. If he finds that his companions or fellow workers are co-operating with him, his morale would be high.
- **Sound and efficient organisation:** Sound and effective organisation is an important factor affecting the employee's morale. At the same time, the chance of communication should be effective and the personal problems of the employee should be heard and redressed as quickly as possible.
- **Fair remuneration:** Fair and reasonable remuneration is essential to secure enthusiasm and willingness of the workers to do the job. The wages should be comparable with those paid in similar concerns. Besides, monetary incentives should be provided to them as and when necessary and possible.
- **Security of job:** If the employee feels secured, they will be willing and co-operative to do the job allotted to them.
- **Opportunity to rise:** The employees should also be made to realise that if they work properly, they will be promoted and adequately rewarded. This feeling of recognition will definitely boost their morale.
- **Working conditions:** The conditions of work at which the employees are required to work also affect their morale. Providing safety measures, hygienic facilities, clean workplace etc. give them satisfaction and boost their morale.
- **Physical & mental health:** An employee with weak health cannot be co-operative and willing to work. Similarly his mental strain shall also reduce his motivation of morale. Both physical and mental illness are detrimental to an individual's work and thereby the organisational output.



MORALE AND PRODUCTIVITY

The satisfaction and comfort an employee experiences at the workplace is termed **morale**. **Morale** is a widely used term in organizations. But in general, it refers to *esprit de corps*, a feeling of enthusiasm, zeal, confidence in individuals or groups that they will be able to cope with the tasks assigned to them. The result of high **morale** generally results in the high efficiency of the organization.

Morale directly impacts the working of an individual in a team towards the realization of common objectives. [Morale](#) therefore is individual specific as well as general. Unfortunately building of morale is not a mechanical problem that could be solved by either rewards or punishments. The best way to manage it is to proactively do a lot of employee related interventions that will together impact morale positively. Morale can also be understood as the spirit and confidence with which the employee performs his job. It is a complex psychological quality that is impossible to force on someone, difficult to measure, and easily destroyed. The level of morale is a result of the degree to which the overall needs of the individual are fulfilled.

It is assumed that high morale and high productivity/ high quality and creative work all go hand in hand. Since morale manifests itself in the attitudes of employees, it is important to know about the results of high and low morale. One of the most unpredictable effects of the level of morale is its impact on employee productivity. The productivity of a group is a composite of many factors, at least one of which is the general state of mind or the commitment of the group. Formerly it was thought that high morale resulted in high productivity. Research is repeatedly proving that this correlation is not as simple. Various studies have revealed that the group having the highest morale need not always be the highest in productivity. As morale is made up of so many factors, so is productivity, the result of a series of complex factors. When a group is convinced that high productivity will result in its getting the things it wants most, it is reasonable to believe that productivity will be high. It is likewise reasonable to believe that if the group's satisfactions in the work situation are high and high productivity will enable it to get the things it wants most, the productivity may be high.

Though high morale may not be the single cause of the high productivity, a high-producing group nearly always has a reasonably high morale, in terms of the company as

a whole. Morale development is almost certain to accompany successful operations where the individuals can relate their respective endeavors and objectives to the success of the enterprise as a whole. “A morale-building organization tends to utilize fully the skill, initiative, judgement, and training of its members, and through such utilization succeeds in building up these and other qualities in everyone, so that the abilities of all constantly expand, and the organization thus is able to succeed and grow.”

INDUSTRIAL RELATIONS

Industrial relation means the relationship between employers and employees in course of employment in industrial organisations. However, the concept of Industrial Relations has a broader meaning. In a broad sense, the term Industrial Relations includes the relationship between the various unions, between the state and the unions as well as those between the various employers and the government. Relations of all those associated in an industry may be called Industrial Relations.

According to International Labour Organization, Industrial relations comprise relationships between the state on one hand and the employer's and employee's organisation on the other, and the relationship among the occupational organisations themselves.

Definition: According to J.T. Dunlop, “Industrial relations are the complex interrelations among managers, workers and agencies of the government”

Features of Industrial Relations:

1. Industrial relations are outcomes of employment relationships in an industrial enterprise. These relations cannot exist without the two parties namely employers and employees.
2. Industrial relations system creates rules and regulations to maintain harmonious relations.
3. The government intervenes to shape the industrial relations through laws, rules, agreements, terms, charters etc.
4. Several parties are involved in the Industrial relations system. The main parties are employers and their associations, employees and their unions and the government.

These three parties interact within economic and social environment to shape the Industrial relations structure.

5. Industrial relations are a dynamic and developing concept, not a static one. They undergo changes with changing structure and scenario of the industry as and when change occurs.
6. Industrial relations include both individual relations and collective relationships.

Objectives of Industrial Relations:

1. To maintain industrial democracy based on participation of labour in the management and gains of industry.
2. To raise productivity by reducing tendency of high labour turnover and absenteeism.
3. To ensure workers' participation in management of the company by giving them a fair say in decision-making and framing policies.
4. To establish a proper channel of communication.
5. To increase the morale and discipline of the employees.
6. To safeguard the interests of the labour as well as management by securing the highest level of mutual understanding and goodwill between all sections in an industry.
7. To avoid all forms of industrial conflicts so as to ensure industrial peace by providing better living and working standards for the workers.
8. To bring about government control over such industrial units which are running at a loss for protecting the livelihood of the employees.

Importance of Industrial Relations:

1. **Uninterrupted Production:** The most important benefit of industrial benefits is that it ensures continuity of production. This means continuous employment for all involved right from managers to workers. There is uninterrupted flow of income for all. Smooth running of industries is important for manufacturers, if their products are perishable goods and to consumers if the goods are for mass consumption (essential commodities, food grains etc.). Good industrial relations bring industrial peace which in turn tends to increase production.
2. **Reduction in Industrial disputes:** Good Industrial relations reduce Industrial disputes. Strikes, grievances and lockouts are some of the reflections of Industrial unrest. Industrial peace helps in promoting co-operation and increasing production.

Thus good Industrial relations help in establishing Industrial democracy, discipline and a conducive workplace environment.

3. **High morale:** Good Industrial relations improve the morale of the employees and motivate the worker workers to work more and better.
4. **Reduced wastage:** Good Industrial relations are maintained on the basis of co-operation and recognition of each other. It helps to reduce wastage of material, manpower and costs.
5. Contributes to economic growth and development.

Causes of poor Industrial Relations:

1. **Economic causes:** Often poor wages and poor working conditions are the main causes for unhealthy relations between management and labour. Unauthorised deductions from wages, lack of fringe benefits, absence of promotion opportunities, faulty incentive schemes are other economic causes. Other causes for Industrial conflicts are inadequate infrastructure, worn-out plant and machinery, poor layout, unsatisfactory maintenance etc.
2. **Organisational causes:** Faulty communications system, unfair practices, non-recognition of trade unions and labour laws are also some other causes of poor relations in industry.
3. **Social causes:** Uninteresting nature of work is the main social cause of poor Industrial relations. Dissatisfaction with job and personal life culminates into Industrial conflicts.
4. **Psychological causes:** Lack of job security, non-recognition of merit and performance, poor interpersonal relations are the psychological reasons for unsatisfactory employer-employee relations.
5. **Political causes:** Multiple unions, inter-union rivalry weaken the trade unions. Defective trade unions system prevailing in the country has been one of the most responsible causes for Industrial disputes in the country.

Suggestions to improve Industrial Relations:

1. **Sound personnel policies:** Policies and procedures concerning the compensation, transfer and promotion, etc. of employees should be fair and transparent. All policies

and rules relating to Industrial relations should be fair and transparent to everybody in the enterprise and to the union leaders.

2. **Participative management:** Employees should associate workers and unions in the formulation and implementation of HR policies and practices.
3. **Responsible unions:** A strong trade union is an asset to the employer. Trade unions should adopt a responsible rather than political approach to industrial relations.
4. **Employee welfare:** Employers should recognise the need for the welfare of workers. They must ensure reasonable wages, satisfactory working conditions, and other necessary facilities for labour. Management should have a genuine concern for the welfare and betterment of the working class.
5. **Grievance procedure:** A well-established and properly administered system committed to the timely and satisfactory redressal of employee's grievances can be very helpful in improving Industrial relations. A suggestion scheme will help to satisfy the creative urge of the workers.
6. **Constructive attitude:** Both management and trade unions should adopt positive attitude towards each other. Management must recognise unions as the spokesmen of the workers' grievances and as custodians of their interests. The employer should accept workers as equal partners in a joint endeavour for good Industrial relations.
7. Creating a proper communication channel to avoid grievances and misunderstandings among employees
8. Education and training imparted to the employees

EMPLOYEE WELFARE IN INDIA

The Directive Principles of State Policy in our Constitution expresses the need for labour welfare thus:

1. The State shall strive to promote the welfare of the people by securing and protecting as effectively as it may a social order in which justice, social, economic and political, shall inform all the institutions of the national life.
2. The State shall, in particular, direct its policy towards securing:
3. That the citizens, men and women equally, have the right to an adequate means of livelihood;
4. That the ownership and control of the material resources are so distributed as to subserve the common good.

5. The State shall make provision for securing just and humane conditions of work and for maternity relief.

Employee Welfare:

Toilets, wash-hand basins, shower and washing facilities Employer must provided

clean well-ventilated toilets (separate for men and women unless each convenience has its own lockable door);

Facilities for Women:

Facilities for Men:

- a. Wash basins with hot and cold (or warm) running water;
- b. Showers for dirty work which may result in contamination of the skin;
- c. Soap and towels (or a hand drier).

Drinking Water:

Employer must supply high-quality drinking water, with and upward drinking jet or suitably cups. Drinking water does not have to be marked unless there is a significant risk of people drinking non-drinking water.

Accommodation for clothing and changing facilities:

Employer must provide lockers or hanging space for clothing and changing facilities where workers wear special clothing. The facilities should allow for drying clothes.

Facilities to Rest and Eat Meals:

Employer must provide places to eat, and rest facilities if you have pregnant women and nursing mothers on staff.



Factories Act, 1948:

The principal Act to provide for various labour welfare measures in India is the Factories Act, 1948. The Act applies to all establishments employing 10 or more workers where power is used and 20 or more workers where power is not used, and where a manufacturing process is being carried on.

Employee Welfare Officer:

Section 49 of the factories act provides that in every factory wherein 500 or more workers are ordinarily employed the employer shall appoint at least one welfare officer.

The welfare officer should possess:

- (i) A university degree;
- (ii) Degree or diploma in social service or social work or social welfare from a recognized institution; and
- (iii) Adequate knowledge of the language spoken by the majority of the workers in the area where the factory is situated.

i. Supervision

ii. Counselling workers

iii. Advising management

iv. Establishing liaison with workers

v. Working with management and workers to improve productivity.

vi. Working with outside public to secure proper enforcement of various acts.

Health of Employees:

a. Cleanliness:



Every factory shall be kept clean by daily sweeping or washing the floors and work rooms and by using disinfectant where necessary.

b. Disposal of Wastes and Effluents:

Effective arrangements shall be made for the disposal of wastes and for making them innocuous.

c. Ventilation and Temperature:

Effective arrangements shall be made for ventilation and temperature so as to provide comfort to the workers and prevent injury to their health.

d. Dust and Fume:

Effective measures shall be taken to prevent the inhalation and accumulation of dust and fumes or other impurities at the work place.

e. Artificial Humidification:

The State Government shall make rules prescribing standard of humidification and methods to be adopted for this purpose.

f. Overcrowding:

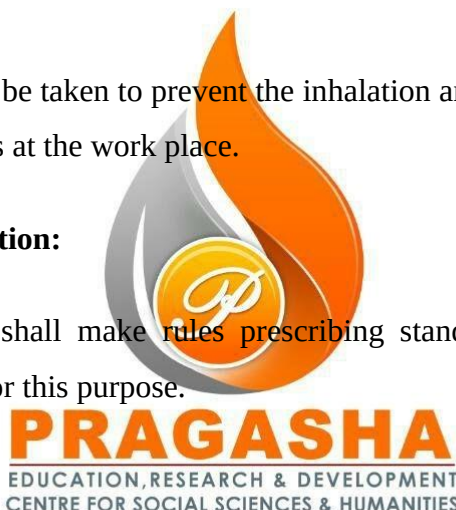
There shall be in every work room of a factory in existence on the date of commencement of this act at least 9.9 cubic meters and of a factory built after the commencement of this act at least 4.2 cubic meters of space for every employee.

g. Lighting:

The State Government may prescribe standards of sufficient and suitable lighting.

h. Drinking Water:

There shall be effective arrangement for wholesome drinking water for workers at convenient points.



i. Latrines and Urinals:

There shall be sufficient number of latrines and urinals, clean, well-ventilated, conveniently situated and built according to prescribed standards separately for male and female workers.

j. Spittoons:

There shall be sufficient number of spittoons placed at convenient places in the factory.

Some of the Health Issues Are Narrated Below Ventilation:

There must be good ventilation:

- a. A supply of fresh, clean air drawn from outside or ventilation systems. It must be uncontaminated and circulated throughout the workplace.
- b. Ventilation should also remove and dilute warm air and create air movement without draughts.

Temperature:

In indoor workplaces, employer must provide:

- a. A reasonable working temperature; usually at least 16°C, or 13°C for strenuous work (unless other laws require lower temperatures);
- b. Local heating or cooling where a comfortable temperature cannot be maintained throughout each workroom, for example, hot and cold processes;
- c. Thermal clothing and rest facilities where necessary, for example for 'hot work' or cold stores;
- d. Heating systems which do not give off dangerous or offensive levels of fume into the workplace;
- e. Sufficient space in workrooms.



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Lighting:

Employer must provide:

- a. Good light; use natural light where possible, but try to avoid glare;
- b. A good level of local lighting at workstations where necessary;
- c. Suitable forms of lighting. Some fluorescent tubes flicker and can be dangerous with some rotating machinery (because the rotating part can appear to have stopped).

Cleanliness and Waste Materials:

Employer must:

- a. Provide clean premises, furniture and fittings such as lights;
- b. Provide clean floors and stairs, which are not slippery;
- c. Provide containers for waste materials;
- d. Remove dirt, refuse and trade waste regularly;
- e. Clear up spillages promptly;
- f. Keep internal walls and ceilings clean.



Workstations and Seating:

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Workstations must fit the worker and the work and people should be able to leave them swiftly in an emergency.

Make sure that:

- a. Seat back rests support the small of the back and must provide foot rests if necessary;
- b. Work surfaces are at a sensible height;
- c. There is easy access to controls on equipment.

Safety of Employees:

1. Fencing of Machinery:

All dangerous and moving parts of a machinery shall be securely fenced. Screws, bolts and teeth shall be completely encased to prevent danger.

2. Work on or Near Machinery in Motion:

Lubrication or other adjusting operation on a moving machinery shall be done only by a specially trained adult male worker.

3. Employment of Young Persons on Dangerous Machines:

No young person shall be allowed to work on any dangerous machine (so prescribed by the state government) unless he is sufficiently trained or is working under the supervision of knowledgeable person.

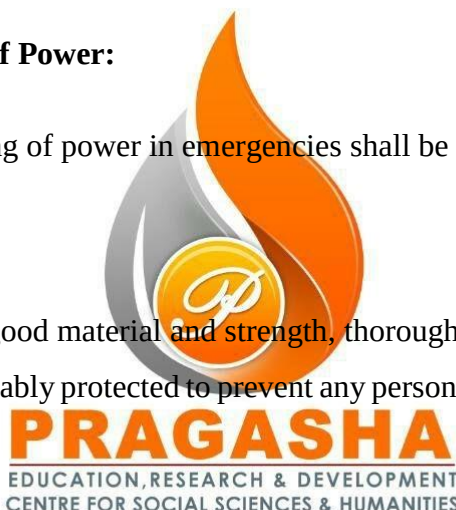
4. Device for Cutting off Power:

Suitable device for cutting of power in emergencies shall be provided.

5. Hoists and Lifts:

These shall be made of good material and strength, thoroughly examined at least once in every six months and suitably protected to prevent any person or thing from being trapped.

Welfare of Employees:



Chapter V of the factories Act contains provisions about the welfare of employees.

These are as follows:

- a. There shall be separate and adequately screened washing facilities for the use of male and female employees.
- b. There shall be suitable places provided for clothing not worn during working hours and for the drying of wet clothing.
- c. There shall be suitable arrangement for all workers to sit for taking rest if they are obliged to work in a standing position.

d. There shall be provided the required number of first-aid boxes or cupboard (at the rate of one for every 150 workers) equipped with the prescribed contents readily available during the working hours of the factory.

e. The State Government may make rules requiring that in any specified factory employing more than 250 employees a canteen shall be provided and maintained by the occupier for the use of the employee.

f. There shall be provided sufficiently lighted and ventilated lunch room if the number of employees ordinarily employed is more than 150.

Restrictions in the Factories Act on the employment of young persons:

1. Prohibition as to Employment of Children (Section 67):

No child who has not completed his fourteenth year shall be required or allowed to work in any factory.

2. Employment of Children and Adolescent (Section 68):

A child who has completed his fourteenth year or an adolescent shall not be required or allowed to work in any factory unless following conditions are fulfilled:

1. The manager of the factory has obtained a certificate of fitness granted to such young
2. While at work, such child or adolescent carries a token giving reference to such certificate.

3. Certificate of Fitness (Section 69):

Before a young person is employed in the factory, a certifying surgeon has to certify that such person is fit for that work in the factory.

Welfare Funds:

In order to provide welfare facilities to the workers employed in mica, iron, ore, manganese ore and chrome ore, limestone and dolomite mines and in the beedi industry, the welfare funds have been established to supplement the efforts of the employers and

the State Government under respective enactments. The welfare measures financed out of the funds relate to development of medical facilities, housing, supply of drinking water, support for education of dependents and recreation, etc.

Voluntary Benefits:

Benefits are also given voluntarily to workers by some progressive employers. These include loans for purchasing houses and for educating children, leave travel concession, fair price shops for essential commodities and loans to buy personal conveyance.

Machinery Connected with Employee Welfare Work:

1. Chief Inspector of Factories:

It is the duty of the Chief inspector of factories (who generally works under the administrative control of the labour commissioner in each state) to ensure enforcement of various provisions of Factories Act in respect of safety, health and welfare of workers.

2. Central Labour Institute:

The institute was set up in Bombay in 1966 to facilitate the proper implementation of the Factories Act, 1948; to provide a centre of information for inspectors, employers, workers and others concerned with the well being of industrial labour and to stimulate interest in the application of the principles of industrial safety, health and welfare.

3. National Safety Council:

The National Safety Council was set up on 4th March, 1966 in Bombay at the initiative of the Union Ministry of Labour and Rehabilitation, Government of India, as an autonomous national body with the objective of generating developing and sustaining an movement of safety awareness at the national level.

4. Director General of Mines Safety:

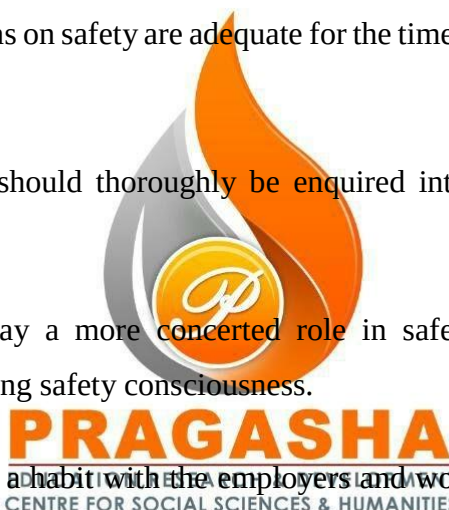
The Director General of Mines Safety enforces the Mines Act, 1952. He inspects electrical installation and machinery provided in the mines and determines the thickness of barriers of 2 adjacent mines in order to prevent spread of fire and danger of inundation.

Appraisal of Welfare Services:

1. One of the main obstacles in the effective enforcement of the welfare provisions of the Factories Act has been the quantitative and qualitative inadequacy of the inspection staffs.
2. At present, a labour welfare officer is not able to enforce laws independently because he has to work under the pressure of management.
3. Women workers do not make use of the crèche facilities either because they are dissuaded by the management to bring their children with them or because they have to face transport difficulties.

National Commission on Employee Recommendations:

1. The statutory provisions on safety are adequate for the time being effective enforcement is the current need.
2. Every fatal accident should thoroughly be enquired into and given wide publicity among workers.
3. Employers should play a more concerted role in safety and accident prevention programme and in arousing safety consciousness.
4. Safety should become a habit with the employers and workers instead of remaining a mere ritual as at present.
5. Unions should take at least as much interest in safety promotion as they take in claims for higher wages.



WORKERS' PARTICIPATION IN MANAGEMENT

Workers' participation in management is an essential ingredient of Industrial democracy. The concept of workers' participation in management is based on Human Relations approach to Management which brought about a new set of values to labour and management.

Traditionally the concept of Workers' Participation in Management (WPM) refers to participation of non-managerial employees in the decision-making process of the

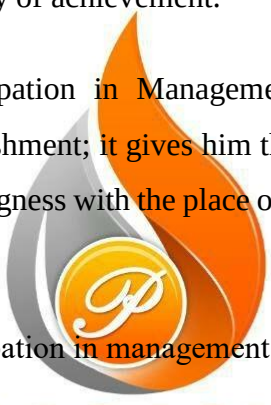
organization. Workers' participation is also known as 'labour participation' or 'employee participation' in management. In Germany it is known as co-determination while in Yugoslavia it is known as self-management. The International Labour Organization has been encouraging member nations to promote the scheme of Workers' Participation in Management.

Workers' participation in management implies mental and emotional involvement of workers in the management of Enterprise. It is considered as a mechanism where workers have a say in the decision-making.

Definition: According to Keith Davis, Participation refers to the mental and emotional involvement of a person in a group situation which encourages him to contribute to group goals and share the responsibility of achievement.

According to Walpole, Participation in Management gives the worker a sense of importance, pride and accomplishment; it gives him the freedom of opportunity for self-expression; a feeling of belongingness with the place of work and a sense of workmanship and creativity.

The concept of workers' participation in management encompasses the following:

- 
- It provides scope for employees in decision-making of the organization.
 - The participation may be at the shop level, departmental level or at the top level.
 - The participation includes the willingness to share the responsibility of the organization by the workers.

Features of WPM:

1. Participation means mental and emotional involvement rather than mere physical presence.
2. Workers participate in management not as individuals but collectively as a group through their representatives.

3. Workers' participation in management may be formal or informal. In both the cases it is a system of communication and consultation whereby employees express their opinions and contribute to managerial decisions.

There can be 5 levels of Management Participation or WPM:

1. **Information participation:** It ensures that employees are able to receive information and express their views pertaining to the matter of general economic importance.
2. **Consultative importance:** Here workers are consulted on the matters of employee welfare such as work, safety and health. However, final decision always rests with the top-level management, as employees' views are only advisory in nature.
3. **Associative participation:** It is an extension of consultative participation as management here is under the moral obligation to accept and implement the unanimous decisions of the employees. Under this method the managers and workers jointly take decisions.
4. **Administrative participation:** It ensures greater share of workers' participation in discharge of managerial functions. Here, decisions already taken by the management come to employees, preferably with alternatives for administration and employees have to select the best from those for implementation.
5. **Decisive participation:** Highest level of participation where decisions are jointly taken on the matters relating to production, welfare etc.



Objectives of WPM:

1. To establish Industrial Democracy.
2. To build the most dynamic Human Resources.
3. To satisfy the workers' social and esteem needs.
4. To strengthen labour-management co-operation and thus maintain Industrial peace and harmony.
5. To promote increased productivity for the advantage of the organization, workers and the society at large.
6. Its psychological objective is to secure full recognition of the workers.

Strategies / Methods / Schemes / Forms of WPM:

1. **Suggestion schemes:** Participation of workers can take place through suggestion scheme. Under this method workers are invited and encouraged to offer suggestions for improving the working of the enterprise. A suggestion box is installed and any worker can write his suggestions and drop them in the box. Periodically all the suggestions are scrutinized by the suggestion committee or suggestion screening committee. The committee is constituted by equal representation from the management and the workers. The committee screens various suggestions received from the workers. Good suggestions are accepted for implementation and suitable awards are given to the concerned workers. Suggestion schemes encourage workers' interest in the functioning of an enterprise.

2. **Works committee:** Under the Industrial Disputes Act, 1947, every establishment employing 100 or more workers is required to constitute a works committee. Such a committee consists of equal number of representatives from the employer and the employees. The main purpose of this committee is to provide measures for securing and preserving amity and good relations between the employer and the employees.

Functions: Works committee deals with matters of day-to-day functioning at the shop floor level. Works committees are concerned with:

- ð Conditions of work such as ventilation, lighting and sanitation.
- ð Amenities such as drinking water, canteens, dining rooms, medical and health services.
- ð Educational and recreational activities.
- ð Safety measures, accident prevention mechanisms etc.

Works committees function actively in some organizations like Tata Steel, HLL, etc but the progress of Works Committees in many organizations has not been very satisfactory due to the following reasons:

- Lack of competence and interest on the part of workers' representatives.
- Employees consider it below their dignity and status to sit alongside blue-collar workers.
- Lack of feedback on performance of Works Committee.

- Undue delay and problems in implementation due to advisory nature of recommendations.

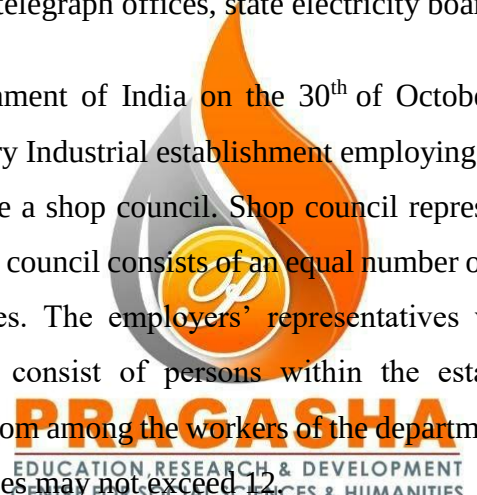
3. **Joint Management Councils:** Under this system Joint Management Councils are constituted at the plant level. These councils were setup as early as 1958. These councils consist of equal number of representatives of the employers and employees, not exceeding 12 at the plant level. The plant should employ at least 500 workers. The council discusses various matters relating to the working of the industry. This council is entrusted with the responsibility of administering welfare measures, supervision of safety and health schemes, scheduling of working hours, rewards for suggestions etc. Wages, bonus, personal problems of the workers are outside the scope of Joint management councils. The council is to take up issues related to accident prevention, management of canteens, water, meals, revision of work rules, absenteeism, indiscipline etc. the performance of Joint Management Councils have not been satisfactory due to the following reasons:

- Workers' representatives feel dissatisfied as the council's functions are concerned with only the welfare activities.
- Trade unions fear that these councils will weaken their strength as workers come under the direct influence of these councils.

4. **Work directors:** Under this method, one or two representatives of workers are nominated or elected to the Board of Directors. This is the full-fledged and highest form of workers' participation in management. The basic idea behind this method is that the representation of workers at the top-level would usher Industrial Democracy, congenial employee-employer relations and safeguard the workers' interests. The Government of India introduced this scheme in several public sector enterprises such as Hindustan Antibiotics, Hindustan Organic Chemicals Ltd etc. However the scheme of appointment of such a director from among the employees failed miserably and the scheme was subsequently dropped.

5. **Co-partnership:** Co-partnership involves employees' participation in the share capital of a company in which they are employed. By virtue of their being shareholders, they have the right to participate in the management of the company. Shares of the company can be acquired by workers making cash payment or by way of stock options scheme. The basic objective of stock options is not to pass on control in the hands of employees but providing

better financial incentives for industrial productivity. But in developed countries, WPM through co-partnership is limited.

6. **Joint Councils:** The joint councils are constituted for the whole unit, in every Industrial Unit employing 500 or more workers, there should be a Joint Council for the whole unit. Only such persons who are actually engaged in the unit shall be the members of Joint Council. A joint council shall meet at least once in a quarter. The chief executive of the unit shall be the chairperson of the joint council. The vice-chairman of the joint council will be nominated by the worker members of the council. The decisions of the Joint Council shall be based on the consensus and not on the basis of voting. In 1977 the above scheme was extended to the PSUs like commercial and service sector organizations employing 100 or more persons. The organizations include hotels, hospitals, railway and road transport, post and telegraph offices, state electricity boards.
7. **Shop councils:** Government of India on the 30th of October 1975 announced a new scheme in WPM. In every Industrial establishment employing 500 or more workmen, the employer shall constitute a shop council. Shop council represents each department or a shop in a unit. Each shop council consists of an equal number of representatives from both employer and employees. The employers' representatives will be nominated by the management and must consist of persons within the establishment. The workers' representatives will be from among the workers of the department or shop concerned. The total number of employees may not exceed 12.
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- The logo for Pragasha Education Research & Development is a circular emblem. It features a stylized orange flame or drop shape on the right side, with a yellow circle in the center containing a white 'P'. Below the emblem, the word 'PRAGASHA' is written in large, bold, orange capital letters. Underneath that, in smaller blue capital letters, is 'EDUCATION RESEARCH & DEVELOPMENT', and at the bottom, in even smaller blue capital letters, is 'CENTRE FOR SOCIAL SCIENCES & HUMANITIES'.

Functions of Shop Councils:

1. Assist management in achieving monthly production targets.
2. Improve production and efficiency, including elimination of wastage of man power.
3. Study absenteeism in the shop or department and recommend steps to reduce it.
4. Suggest health, safety and welfare measures to be adopted for smooth functioning of staff.
5. Look after physical conditions of working such as lighting, ventilation, noise and dust.
6. Ensure proper flow of adequate two way communication between management and workers.

Workers' Participation in Management in India

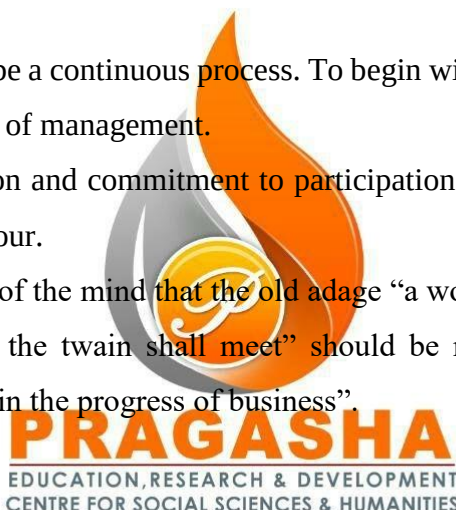
Workers' participation in Management in India was given importance only after Independence. Industrial Disputes Act, 1947 was the first step in this direction, which recommended for the setting up of works committees. The joint management councils were established in 1950 which increased the labour participation in management. Since July 1975 the two-tier participation called shop councils at shop level and Joint councils were introduced. Workers' participation in Management Bill, 1990 was introduced in Parliament which provided scope for upliftment of workers.

Reasons for failure of Workers participation Movement in India:

1. Employers resist the participation of workers in decision-making. This is because they feel that workers are not competent enough to take decisions.
2. Workers' representatives who participate in management have to perform the dual roles of workers' spokesman and a co-manager. Very few representatives are competent enough to assume the two incompatible roles.
3. Generally Trade Unions' leaders who represent workers are also active members of various political parties. While participating in management they tend to give priority to political interests rather than the workers' cause.
4. Schemes of workers' participation have been initiated and sponsored by the Government. However, there has been a lack of interest and initiative on the part of both the trade unions and employers.
5. In India, labour laws regulate virtually all terms and conditions of employment at the workplace. Workers do not feel the urge to participate in management, having an innate feeling that they are born to serve and not to rule.
6. The focus has always been on participation at the higher levels, lower levels have never been allowed to participate much in the decision-making in the organizations.
7. The unwillingness of the employer to share powers with the workers' representatives, the disinterest of the workers and the perfunctory attitude of the government towards participation in management act as stumbling blocks in the way of promotion of participative management.

Measures for making Participation effective:

1. Employer should adopt a progressive outlook. They should consider the industry as a joint endeavor in which workers have an equal say. Workers should be provided and enlightened about the benefits of their participation in the management.
2. Employers and workers should agree on the objectives of the industry. They should recognize and respect the rights of each other.
3. Workers and their representatives should be provided education and training in the philosophy and process of participative management. Workers should be made aware of the benefits of participative management.
4. There should be effective communication between workers and management and effective consultation of workers by the management in decisions that have an impact on them.
5. Participation should be a continuous process. To begin with, participation should start at the operating level of management.
6. A mutual co-operation and commitment to participation must be developed by both management and labour.
7. Modern scholars are of the mind that the old adage “a worker is a worker, a manager is a manager; never the twain shall meet” should be replaced by “managers and workers are partners in the progress of business”.



Unit - 9: Banking and Financial Institution

- ✓ Importance of Banking to Business, Types of Banking and Their Functions, Reserve Bank of India, NABARD and Rural Banking
- ✓ Banking Sector Reforms in India, NPA, Capital Adequacy Norms
- ✓ E-Banking
- ✓ Development Banking: IDBI, IFSC, SFCs, UTI, SIDBI

INDIAN BANKING SYSTEM – EVOLUTION

Indian Banking System for the last two centuries has seen many developments. An indigenous banking system was being carried out by the businessmen called Sharoffs, Seths, Sahukars, Mahajans, Chettis, etc. since ancient time. They performed the usual functions of lending moneys to traders and craftsmen and sometimes placed funds at the disposal of kings for financing wars. The indigenous bankers could not, however, develop to any considerable extent the system of obtaining deposits from the public, which today is an important function of a bank.

Modern banking in India originated in the last decades of the 18th century. The first banks were The General Bank of India which started in 1786, and the Bank of Hindustan. Thereafter, three presidency banks namely the Bank of Bengal (this bank was originally started in the year 1806 as Bank of Calcutta and then in the year 1809 became the Bank of Bengal), the Bank of Bombay and the Bank of Madras, were set up. For many years the Presidency banks acted as quasi-central banks. The three banks merged in 1925 to form the Imperial Bank of India. Indian merchants in Calcutta established the Union Bank in 1839, but it failed in 1848 as a consequence of the economic crisis of 1848-49. Bank of Upper India was established in 1863 but failed in 1913. The Allahabad Bank, established in 1865, is the oldest survived Joint Stock bank in India. Oudh Commercial Bank, established in 1881 in Faizabad, failed in 1958. The next was the Punjab National Bank, established in Lahore in 1895, which is now one of the largest banks in India. The Swadeshi movement inspired local businessmen and political figures to found banks of and for the Indian community during 1906 to 1911. A number of banks established then have survived to the present such as Bank of India, Corporation Bank, Indian Bank, Bank of Baroda, Canara Bank and Central Bank of India. A major landmark in Indian banking history took place in 1934 when a decision was taken to establish 'Reserve Bank of India'

which started functioning in 1935. Since then, RBI, as a central bank of the country, has been regulating banking system.

Banking System in India

A (commercial bank) is a type of financial intermediary.. It is a financial intermediary because it mediates between the savers and borrowers). It does so by accepting deposits from the public and lending money to businesses and consumers. Its primary liabilities are deposits and primary assets are loans and bonds.

“Commercial bank” has to be distinguished from another type called “investment bank”. (Investment banks assist companies in raising funds in the capital markets (both equity and debt)), as well as in providing strategic advisory services for mergers, acquisitions and other types of financial transactions. It is also called merchant bank.

The commercial banking system in India consists of public sector banks; private sector banks and cooperative banks.

Currently, India has 88 scheduled commercial banks (SCBs) – 25 public sector banks (that is with the Government of India holding majority stake), 31 private banks and 38 foreign banks. Public sector banks hold over 75 percent of total assets of banking industry, with the private and foreign banks holding 18.2% and 6.5 respectively.

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Public Sector Banks

They are owned by the Government either totally or as a majority stake holder.

- State Bank of India and its five associate banks called the State Bank group
- 19 nationalized banks
- Regional Rural Banks mainly sponsored by Public Sector Banks

SBI has five associate banks: State Bank of Bikaner & Jaipur, State Bank of Hyderabad, State Bank of Mysore, State Bank of Patiala and State Bank of Travancore. Earlier SBI had seven associate banks. State Bank of Saurashtra and Indore merged with SBI.

Private Sector Banks include domestic and foreign banks Co-operative Banks are another class of banks and are not considered as commercial banks as they have social objectives

and profit is not the motive. (explained later) Reserve Bank of India lays down the norms for banking operations and has the final supervising power.

Development Banks

Development Banks are those financial institutions which provide long term capital for industries and agriculture : Industrial Finance Corporation of India (IFCI); Industrial Development Bank of India (IDBI); Industrial Credit and Investment Corporation of India (ICICI) that was merged with the ICICI Bank in 2000; Industrial Investment Bank of India (IIBI); Small Industries Development Bank of India (SIDBI); National Bank for Agriculture and Rural Development (NABARD); Export Import Bank of India; National Housing Bank (NHB).

The commercial banking network essentially catered to the needs of general banking and for meeting the short-term working capital requirements of industry and agriculture. Specialized development financial institutions (DFIs) such as the IDBI, NABARD, NHB and SIDBI, etc., with majority ownership of the Reserve Bank were set up to meet the long-term financing requirements of industry and agriculture. To facilitate the growth of these institutions, a mechanism to provide concessional finance to these institutions was also put in place by the Reserve Bank.

The first development bank in India- IFCI- was incorporated immediately after Independence in 1948 under the Industrial Finance Corporation Act as a statutory corporation to pioneer institutional credit to medium and large-scale. Then after in regular intervals the government started new and different development financial institutions to attain the different objectives and helpful to five-year plans. Government utilized these institutions for the achievements in planning and development of the nation as a whole. The all India financial institutions can be classified under four heads according to their economic importance that are:

- All-India Development Banks
- Specialized Financial Institutions (SIDBI)
- Investment Institutions (The Industrial Reconstruction Corporation of India Ltd., set up in 1971 for rehabilitation of sick industrial companies)
- State-level institutions (SFC)

(S.H. Khan committee appointed by RBI (1997) recommended to transform the DFI (development finance institution)) into universal banks that can provide a menu of financial services and leverage on their assets and talent.

Nationalization of Banks for implementing Govt. policies

Indian Banking System witnessed a major revolution in the year 1969 when 14 major commercial banks in the private sector were nationalized on 19th July, 1969. Most of these banks having deposits of above Rs. 50 crores were promoted in the past by the industrialists. These banks were:

1. Allahabad Bank
2. Bank of Baroda
3. Bank of India
4. Bank of Maharashtra
5. Canara Bank
6. Central Bank of India
7. Dena Bank
8. Indian Bank
9. Indian Overseas Bank
10. Punjab National Bank
11. Syndicate Bank
12. Union Bank of India
13. United Bank of India
14. United Commercial Bank (now known as UCO bank)



The purpose of nationalization was:

- (a) to increase the presence of banks across the nation.
- (b) to provide banking services to different segments of the Society.
- (c) to change the concept of class banking into mass banking, and
- (d) to support priority sector lending and growth.

In 1980, another six more commercial banks with deposits of above Rs. 200 crores were nationalized:

1. Andhra Bank
2. Corporation Bank
3. New Bank of India
4. Punjab and Sind Bank
5. Oriental Bank of Commerce
6. Vijaya Bank

Later on the New Bank of India was merged with Punjab Nationalized Bank. The nationalization of banks resulted in rapid branch expansion and the number of commercial bank branches have increased many folds in Metro, Urban, Semi – Urban and Rural Areas. The branch network assisted banks to mobilize deposits and lot of economic activities have been started on account of priority sector lending.

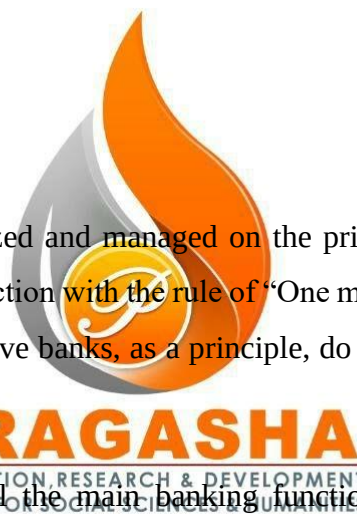
Co-operative Banks

Co-operative Banks are organized and managed on the principle of co-operation, self-help, and mutual help. They function with the rule of “One member, one vote” and on “no profit, no loss” basis Co-operative banks, as a principle, do not pursue the goal of profit maximization.

Co-operative bank performs all the main banking functions of deposit mobilization, supply of credit and provision of remittance facilities.

Co-operative Banks provide limited banking products and are functionally specialists in agriculture related products, However, co-operative banks now provide housing loans also.

Urban Co-operative Banks (UCBs) are located in urban and semi-urban areas. These banks, till 1996, were allowed to lend money only for non-agricultural purposes. This distinction does not hold today. Earlier, they essentially lent to small borrowers and businesses. Today, their scope of operations has widened considerably. Urban CBs provide working capital, loans and term loan as well.

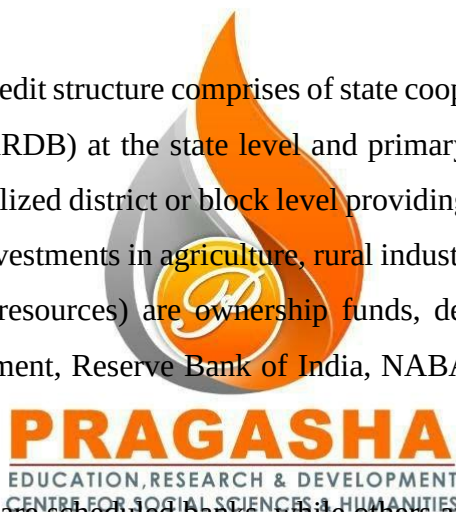


Co-operative banks are the first government sponsored, government-supported, and government- subsidized financial agency in India. They get financial and other help from the Reserve Bank of India, NABRAD, central government and state governments. RBI provides financial resources in the form of contribution to the initial capital (through state government), working capital, refinance.

Co-operative Banks belong to the money market as well as to the capital market- they offer short term and long loans.

Primary agricultural credit societies provide short term and medium term loans. State Co-operative Banks (SCBs) and CCBs (Central Co-operative Banks at the district level) provide both short term and term loans. Land Development Banks (LDBs) provide long-term loans.

Long term cooperative credit structure comprises of state cooperative agriculture and rural development bank (SCARDB) at the state level and primary PCARDBs or branches of SCARDB at the decentralized district or block level providing typically medium and long term loans for making investments in agriculture, rural industries, and lately housing. The sources of their funds (resources) are ownership funds, deposits or debenture issues, central and state government, Reserve Bank of India, NABARD and other co-operative institutions



Some co-operative bank are scheduled banks, while others are non-scheduled banks. For instance, SCBs and some UCBs are scheduled banks (included in the Second Schedule of the Reserve Bank of India Act). Co-operative Banks are subject to CRR and SLR requirements as other banks. However, their requirements are less than commercial banks. Although the main aim of the co-operative bank is to provide cheaper credit to their members and not to maximize profits, they may access the money market to improve their income so as to remain viable.

Regional Rural Banks

In 1975, a new set of banks called the Regional Rural Banks, were setup based on the recommendations of a working group headed by Shri Narasimham, to serve the rural population in addition to the banking services offered by the co-operative banks and

commercial banks in rural areas. Inception of regional rural banks (RRBs) can be seen as a unique experiment as well as experience in improving the efficacy of rural credit delivery mechanism in India. With joint shareholding by Central Government, the concerned State Government and the sponsoring bank, an effort was made to integrate commercial banking within the broad policy thrust towards social banking keeping in view the local peculiarities. RRBs were expected to play a vital role in mobilizing the savings of the small and marginal farmers, artisans, agricultural labourers and small entrepreneurs and inculcate banking habit among the rural people. These institutions were also expected to plug the gap created in extending the credit to rural areas by largely urban-oriented commercial banks and the rural cooperatives, which have close contact with rural areas but fall short in terms of funds.

Commercial Banks

Today banks are broadly classified into two types- Scheduled Banks and Non-scheduled Banks.

Scheduled banks are those banks which are included in the Second Schedule of the Reserve Bank Act, 1934. They satisfy two conditions under the Reserve Bank of India Act.

- paid-up capital and reserves of an aggregate value of not less than 5 lakh.
- it must satisfy RBI that its affairs are not conducted in a manner detrimental to the depositors.

The scheduled banks enjoy certain privileges like approaching RBI for financial assistance; refinance etc. and correspondingly, they have certain obligations like maintaining certain cash reserves as prescribed by the RBI etc. The scheduled banks in India comprise of State Bank of India and its associates (5), the other nationalized banks (19), foreign banks, private sector banks, co-operative banks and regional rural banks. Today, there are about 300 scheduled banks in India having a total network of 79,000 branches among them.

Non-scheduled banks are those banks which are not included in the second schedule of the RBI Act as they do not comply with the above criteria and so they do not enjoy the benefits either. There are only 3 non-scheduled commercial banks operating in the country with a total of 9 branches.

Bank

A commercial bank is a financial intermediary. It accepts the deposits from the surplus units and lends these financial resources to the deficit units. The main aim of the commercial banking sector is profit making.

Functions of commercial banks:

A bank is a financial institution. It is a profit-making business firm dealing with money. Modern banks in India are joint stock companies registered under the Indian Companies Act.

Definition of Bank:

Sayers define bank as, “an institution whose debts (bank deposits) are widely accepted in settlement of other people’s debts”.

According to Crowther, a bank “collects money from those who have it to spare or who are saving it out of their incomes and lends this money to those who require it”.

COMMERCIAL BANKS

Commercial Banks play a very prominent role in the financial system of an economy. They perform a variety of functions as discussed below.

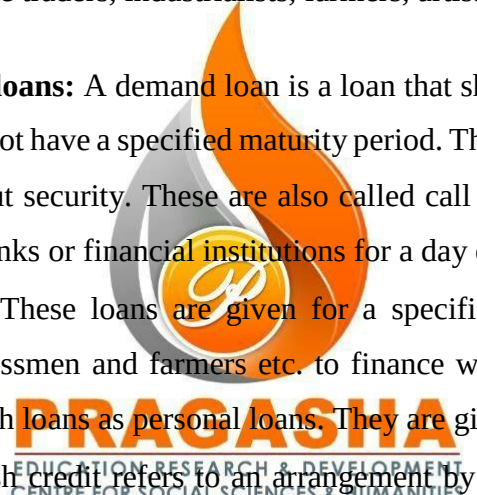
1. Acceptance of deposits: One of the primary functions of a commercial bank is to accept deposits from the public. The deposits accepted by the banks are of the following types.

- **Current deposits:** These are the deposits made into the current account of a bank. They are most convenient to the businessmen, public authorities and joint stock companies because there are no restrictions on the number and the amount of withdrawals.
- **Savings deposits:** These deposits are made into a savings bank account of the bank. They are most convenient to the small businessman, salaried employees, artisans and people belonging to the low and middle income groups. The interest paid on these deposits is comparatively low and is around 4% per annum.

- **Term deposits:** They are also called fixed deposits because the money is deposited with the bank for a fixed period of time. The deposit can be withdrawn after the expiry of maturity period. The minimum period of deposit is 15 days. The rate of interest varies from 6% per annum to 12% per annum.
- **Recurring or cumulative deposits:** These are the variants of fixed deposits. These deposits are very convenient to those who cannot save huge amounts at a time. These deposits carry interest at a rate more than that of savings bank and less than that of a term deposit.

2. Payment of loans and advances:

Another primary function of the commercial bank is to give loans and advances to different sections of the public like traders, industrialists, farmers, artisans etc.

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- **Demand loans/call loans:** A demand loan is a loan that should be repaid on demand by the bank. It does not have a specified maturity period. This loan is a kind of advance made with or without security. These are also called call loans. Normally call loans are given to other banks or financial institutions for a day or a few days.
 - **Short term loans:** These loans are given for a specified short period. They are sanctioned to businessmen and farmers etc. to finance working capital. Individuals may also receive such loans as personal loans. They are given against security.
 - **Cash credits:** A cash credit refers to an arrangement by which the bank allows its customer to borrow money upto a specified limit from an account opened for the purpose. The customer need not withdraw the entire amount in one installment.
 - **Overdraft:** This is a facility allowed by the bank to the current account holders. They are allowed to withdraw money with or without security in excess of the balance available in their account up to a limit. Interest is charged on the amount of actual withdrawal.
 - **Discounting of bills of exchange:** Bills of exchange are undertakings written by the buyers and given to sellers when the transaction is made on credit basis. The buyer undertakes to make payment after a specified period or on a specified future date. The traders who possess such bills of exchange with them may approach the banks for discounting of the bills of exchange when they need money.

- **Credit cards:** Now-a-days, the banks have devised new methods of giving loans to the customers. One such popular method is issuance of the credit card. A credit cardholder can use his card to purchase goods on credit from specified firms and shops and also withdraw cash subjects to certain regulations.

3. Creation of Credit: The commercial banks create credit. This is a unique function of commercial banks. Credit is created from out of the primary deposits of money the customers received from the public. Part of the total amount of these deposits is given as loans and advances to its customers.

4. Agency Functions:

Commercial banks perform certain agency functions also:

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- (a) Collection of cheques, drafts, bills of exchange etc. of their customers from other banks.
 - (b) Collection of dividends and interest from business and industrial firms.
 - (c) Purchase and sale of securities, shares, debentures, government securities on behalf of the customers.
 - (d) Acting as trustees and keeping their funds in safe custody, acting as executors and executing the will of the customers after their death.
 - (e) Making payments such as insurance premium, income-tax, subscriptions etc. on behalf of their customers as per their advice.

5. General Utility Functions:

Besides the above agency functions, the commercial banks provide certain general utility services to their customers.

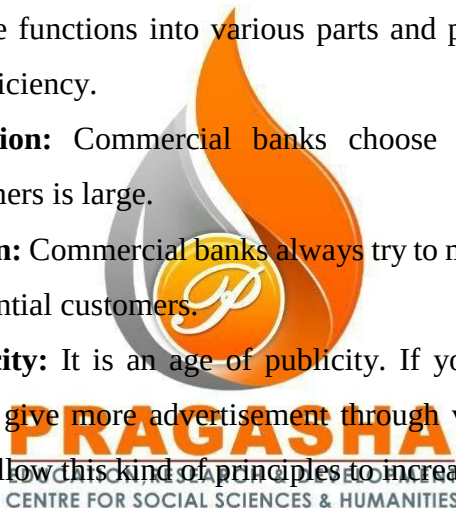
- a) Provide locker facility for the safe custody of the silver, gold ornaments, important and valuable documents.
- b) Transfer money of the customers from one bank to the other by way of demand drafts, mail transfer.
- c) With the use of computers and internet facility, now-a-days the banks are facilitating on-line transfer of money from one bank to the other.

- d) Issue letters of credit to enable the customers to purchase commodities on the basis of credit.
- e) Endorse and provide guarantee to the shares issued by the joint stock companies and help them in rising capital.
- f) Traveler's cheques are issued by the commercial banks to avoid the risk of carrying of cash.
- g) Provide foreign exchange to the customers for exports and imports in connection with their business.
- h) Convey information on behalf of their customers to the businessmen operating in other places and also collect information of such businessmen and provide it to the customers.
- i) Recently the commercial banks have been establishing ATMs (Automated Teller Machines) at different locations so as to enable their customers to withdraw cash from their accounts at any ATM at any time in a day.

Principles of Commercial Banks:

1. **Principles of liquidity:** Deposits are repayable on demand or after expiry of a certain period. Everyday depositors either deposit or withdraw cash. To meet the demand for cash, all commercial banks have to keep certain amount of cash in their custody.
2. **Principles of profitability:** The driving force of commercial enterprise is to generate profit. So it is true in case of commercial bank also.
3. **Principles of Solvency:** Commercial bank should have financially sound and maintain a required capital for running the business.
4. **Principles of safety:** While investing the fund, banks are to be cautious because bank's money is depositor's money.
5. **Principles of collection of savings:** This is a very important principle for today's banking business. Commercial banks always seek huge amount of idle money from the clients. Now a day's banks fix up the target for their employees to generate more savings from the people.
6. **Principles of loan and investment policy:** The main earning sources of commercial banks are lending and investing money to the viable projects. So commercial banks always try to earn profit through sound investment.

7. **Principles of economy:** Commercial banks never go for any unnecessary expenditure. They always try to maintain their functions with economy that increase their yearly profit.
8. **Principles of providing services:** A better service brings great reputation for the bank.
9. **Principles of secrecy:** Commercial bank maintains and keeps the clients accounts secretly. Nobody except the legitimized person is allowed to see the accounts of the clients.
10. **Principles of modernization:** It is the age of science and technology. So to cope up with the advanced world the commercial bank has to adopt modern technical services like online banking, credit card etc.
11. **Principles of specialization:** It is an age of specialization. Here commercial banks segments their whole functions into various parts and place their human resources according to their efficiency.
12. **Principles of location:** Commercial banks choose a suitable site where the availability of customers is large.
13. **Principles of relation:** Commercial banks always try to maintain a good relation with their clients and potential customers.
14. **Principles of publicity:** It is an age of publicity. If you would like to earn more money, you have to give more advertisement through various media. In that case, commercial banks follow this kind of principles to increase their customers.



Essentials of a sound Banking System:

A sound banking system promotes all round economic development of an economy. A good bank must have the following features:-

- a) **Adequate Liquidity** - A bank must keep sufficient cash in hand to meet the claim of depositors, otherwise they would be insolvent. A bank failure not only affects depositors but banks also. People would not more keep funds with banker. It ensures safety of a bank. Unless a bank is safe it cannot render its social services.
- b) **Expansion of banking** - Banking facilities should spread throughout the economy. It must also cover all sections of people in need of funds and all productive activities. The less-developed regions should get more banking facilities than others. Thus, diffusion of banking offices is essential.

- c) **Investment and loan policies** – A sound banking system must have a sound investment policy whereby it can optimize the twin goals of liquidity and profitability. If loan and investments are wrong, a bank suffers loss or face liquidity shortage. A prudent banker should carefully determine the composition and character of its loans and advances so as to optimize earning without endangering safety and solvency.
- d) **Human factor** – The soundness of a bank depends much on the quality of banker. Banking being a practical affair, rigid application of bank laws are not always fruitful. Much depends on the discretion of men piloting the ship. Sound banking thus, depends more on banking personnel than on banking laws.

Credit Creation by Commercial bank:

- a) A commercial bank is called a dealer of credit.
- b) It can create credit i.e. can expand the monetary base of a country.
- c) It does so not by issuing new money but by its loan operations.
- d) Banks create money on the basis of the cash deposits.
- e) The process of credit creation is that the depositors think they have so much money with banks and borrowers from bank say they have so much money with them.
- f) Summing the two, we find an amount more than the cash deposit.
- g) Suppose a bank receive a sum of Rs. 1,000 as deposit, keeps with it 20% (Rs. 200) as CRR (cash reserve ratio) and lends and rest.
- h) Depositor will claim he has Rs. 1,000 and bank borrower too possesses Rs. 800.
- i) Thus total money supply appears to be Rs. 1,800 only. It is the credit creation by a single bank.
- j) The above example can be extended to cover the banking system as whole. Suppose Rs. 800 is deposited to another bank.
- k) This bank's base will now expand. It will keep 20% of Rs. 800 (Rs. 160) as cash reserve and will lend Rs. 640.
- l) This sum is redeposited to a third bank which keeps 20% of Rs. 640 (Rs. 128) and grants a loan of Rs. 512.
- m) This process will continue and the mount of fresh deposit will go on falling
- n) A time will come when deposited sum will be equal to CRR.
- o) The process will then come to an end.

Limitations of Credit Creation

- **Size of the cash reserve ratio:** Much depends on the size of the cash reserve ratio. Credit creation is inversely related to CRR.
- **Amount of loan given:** Credit creation depends upon the amount of loan given. If borrowers cannot offer security against loan, bank cannot lend.
- **Size of the cash deposit:** Size of the cash deposit is also important in this context. The smaller the cash base the smaller scope a bank gets for credit creation. If people prefer physical assets or prefer to keep cash in their hand, bank deposits suffer much, so bank cannot lend much.
- **Acceptable securities:** A bank can lend money against acceptable securities. A borrower gets a loan from a bank only against securities the value of which must be equal to the amount of the loan.
- **Controlled by the Central Bank:** A central Bank possesses certain instruments by the use of these it can increase or decrease the volume of credit created by banks.

Credit Control by Central Bank

- ✓ A central bank possesses a number of instruments for controlling credit money.
- ✓ These are of two types – Quantitative and Qualitative.
- ✓ Quantitative techniques seek to regulate total quantity of credit while qualitative measures affect the availability of credit.



Bank Rate Policy:

- As a banker's bank, a central bank lends money or rediscounts the bills of commercial banks.
- The rate of interest charged by the central bank is known as Bank rate or Discount rate.
- By manipulating bank rate central bank can regulate the credit creating power of member banks.
- If bank rate is raised by the central bank, commercial banks are to borrow at a higher cost.
- Then they will increase their lending rate. This rate is known as the market rate.
- The difference between market rate and bank rate is the profit margin of commercial banks.

- When bank rate rises market rate also rises and vice versa.
- Demand for bank loan will reduce.
- On the other hand, for credit expansion, bank rate is reduced.
- The effectiveness of this technique depends on the extent to which commercial banks depend on central bank for loan and rediscounting.
- If banks can collect funds from other sources at relatively cheaper rate, they need not depend on central bank credit.
- Again if investment opportunities are not present, the market demand for credit will be weak, a fall in the bank rate may not raise the level of bank credit.

Open Market Operations:

- It implies purchase and sale of securities in the stock market.
- When the central bank appears in the market as a seller of government securities, people buy such securities by withdrawing money from banks or the banks themselves invest in such securities instead of granting loan to public.
- In either case the powers of creating credit will be restricted.
- On the other hand, if central bank buys securities money flows out thus enlarging the cash base of member banks.
- Credit expansion depends upon external business environment and borrowers' attitudes over which banks have no influence.



Variation or Reserve ratio:

- Commercial banks are legally bound to keep a portion of their deposits in the form of cash reserve.
- It is the most liquid asset in their hand and at the same time it is zero earning assets.
- Naturally by altering the CRR, the central bank can expand or reduce the funds bank can lend.
- There exists an inverse relation between the size of cash reserve and the amount of credit given by a bank, assuming a given amount of deposit.
- In under developed money market this technique is more suitable than open market operation or bank rate policy.

Qualitative Credit controls:

- A central bank also possesses certain techniques by which it can control the direction and distribution of credit – purpose wise or areas wise.
- The purpose of selective controls is the rational allocation of scarce bank credit and its economic utilization.
- Further sectorial development of credit and controlling in other directions serve the purpose of preventing speculative activities with the help of bank finance and favoring productive activities.
- These techniques are very helpful in a less-developed economy where overall credit restriction may hinder growth by preventing the flow of credit for investment.

Moral Suasion:

- Moral suasion is a qualitative technique.
- The central bank ‘requests’ banks to lend more or not to lend in some sectors.
- There is no legal compulsion behind their acceptance.
- Generally, if a request is not carried out by the member bank, the guardian of the banking system may take such steps as banks are forced to accept.
- The central bank is often empowered to issue directives to member banks.
- Such direct orders are in the form of directional control, prohibiting loans of particular type or giving advice to grant loan to priority sectors.



CENTRAL BANK

Central Bank is the apex of the banking system in a country. It controls, regulates and supervises the activities of the banks and the country's banking system. In our country the Central Bank was established in 1935 under private management. It was nationalized by the Government in 1949 and named as RBI.

Reserve Bank of India as a Central Bank of the Country

The Reserve Bank, as the central bank of the country, started their operations as a private shareholder's bank. RBI replaced the Imperial Bank of India and started issuing the currency notes and acting as the banker to the government. Imperial Bank of India was allowed to act as the agent of the RBI. RBI covered all over the undivided India. In order to have close integration between policies of the Reserve Bank and those of the

Government, It was decided to nationalize the Reserve Bank immediately after the independence of the country. From 1st January 1949, the Reserve Bank began functioning as a State-owned and State-controlled Central Bank.. To streamline the functioning of commercial banks, the Government of India enacted the Banking Companies Act,1949 which was later changed as the Banking Regulation Act 1949. RBI acts as a regulator of banks, banker to the Government and banker's bank. It controls financial system in the country through various measures.

Objectives of the Central Bank:

The Central Bank functions with the objectives given below:

- ✓ To maintain the internal value of currency.
- ✓ To preserve the external value of currency.
- ✓ To ensure price stability.
- ✓ To promote financial institutions.
- ✓ To promote economic development.

Functions of a Central Bank:

A Central Bank has the following functions:

1. Note Issue: The Central Bank alone is authorized to issue the currency notes in a country. It has the monopoly of note issue as no other bank is permitted to do so. It also enables the Central Bank to control the supply of money as per the requirements of the economy.

2. Banker to Government: The Central Bank acts as a banker, agent and financial advisor to government in the following ways:

- (a) It maintains the accounts of the government funds.
- (b) It receives money and makes payments on behalf of the government.
- (c) It gives 'ways and means' advances to the government.
- (d) It issues new loans on behalf of the government.
- (e) It manages the public debt.
- (f) It undertakes foreign exchange transactions on behalf of the government.

(g) It acts as the agent of the government in dealing with the international financial institutions like IMF and World Bank.

(h) It advises the Government on all financial matters.

3. Banker's Bank: The Central bank acts as a banker's bank in the following manner.

(a) Every bank maintains a certain minimum of cash reserves with the Central Bank as a statutory obligation.

(b) It serves as a lender of last resort. This helps the commercial banks to overcome the problems of liquidity and will be able to meet the demand for withdrawals even in times of financial stringency.

(c) It acts as a clearing house for the commercial banks to settle their inter-bank accounts. This is possible because all commercial banks have account with the Central Bank in which the Central Bank keeps their cash balances.

4. Lender of last resort: The Central Bank serves a lender of last resort not only to commercial banks but also to discount houses, and other credit institutions. They may approach the central bank when they face the problem of liquidity.

5. Controller of credit: This is the most important function of the Central Bank. It controls the volume of credit in the economy through appropriate monetary policy. It takes steps to reduce the credit in case of inflation.



6. Custodian of foreign exchange reserves: The Central bank maintains the reserves of foreign exchange and regulates their use. It has the responsibility to maintain the stability of the exchange rate of the native currency in terms of the foreign currency.

Money Market

Money market is the nerve center of the financial system. A well-organized money market is the basis for an effective monetary policy. Money market mobilizes savings from different sources and makes them available for investment. It is the mechanism through which funds flow from surplus units to deficit units in the economy.

Meaning of Money Market:

Financial markets are functionally classified into

- (a) Money market and
- (b) Capital market.

This classification is on the basis of the term of credit, i.e., whether the credit is supplied for a short period or long period. Money market refers to institutional arrangements which deal with short- term funds. Capital market, on the other hand deals in long-terms funds. Money market is a short-term credit market which deals with relatively liquid and quickly marketable assets such as, short-term government securities, treasury bills, bills of exchange, etc.,

Definition:

1. According to Crowther, “The money market is a collective name given to the various firms and institutions that deal with various grades of near- money”.
2. The Reserve Bank of India defines money market “as the center for dealing, mainly of a short-term character, in monetary assets; it meets the short-term requirements of borrowers and provides liquidity of cash to the lenders.

Objectives of Money Market:

A well-developed money market serves the following objectives:

- i. Provides an equilibrium mechanism for ironing out short-term surplus and deficits.
- ii. (ii) Provides a focal point for the intervention of the central bank for influencing liquidity in the economy.
- iii. (iii) Provides access to user of short term money to meet their requirements at a reasonable price.

Characteristics of Money Marketing:

Indian money market has major features:

1. Short-term funds are borrowed and lent.

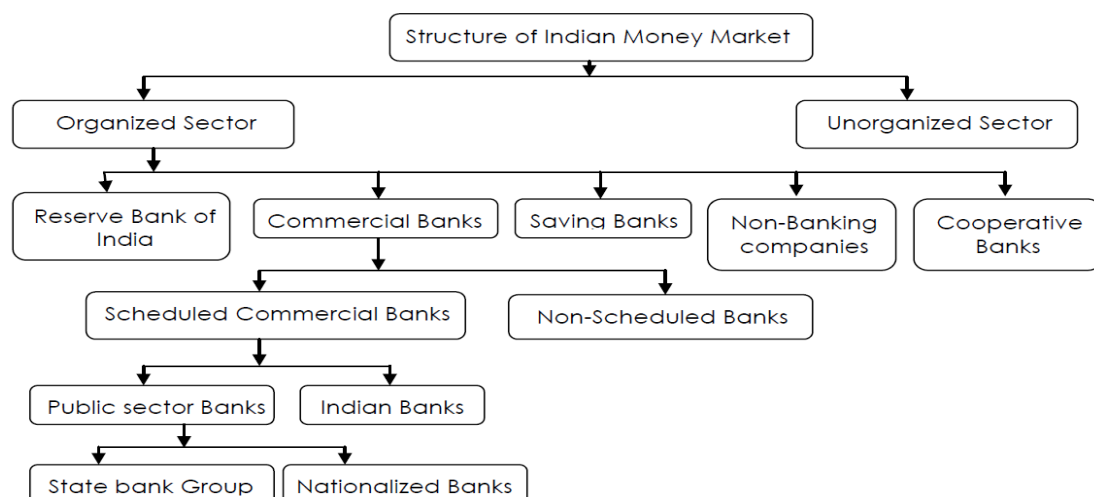
2. No fixed place for conduct of operations. Transactions are conducted even over the phone.
3. Dealing may be conducted with or without the help of brokers.
4. The short-term financial assets that are dealt in are close substitutes for money.
5. Funds are loaned for a maximum period of 1 year.
6. Presence of a large number of sub-markets.

STRUCTURE AND FUNCTIONS OF INDIAN MONEY MARKET

Functions of Money Market:

1. It links lenders and borrowers of short-term funds. It is purely a market for short term funds or financial assets.
2. It provides working capital requirements of industry, trade and agriculture.
3. It provides financial assets with high a degree of liquidity- call money, treasury bills, commercial bills etc.
4. It helps trade and commerce by developing a bill market, and acceptance market.
5. It enables the Government to raise short-term loans with Treasury bill market.
6. It is controlled and regulated by RBI.
7. It makes the monetary policy effective.
8. It provides opportunities for lending the surplus funds of individuals, banks and other institutions.
9. It helps the central bank in maintaining stability of the value of the currency unit.

A well developed money market can perform the above functions effectively.



Organized Sector:

It is called organized because its activities are systematically coordinated by the RBI

Many players are there in the organized sector. They are:

- i. The organized modern sector of Indian money market comprises: (a) the Reserve Bank of India; (b) The State Bank of India and its associate banks; (c) the Indian joint stock commercial banks (Scheduled and non-scheduled) of which 27 scheduled banks have been nationalized (d) the exchange banks which mainly finance Indian foreign trade; (e) cooperative bank; (f) other special institutions, such as, Industrial Development Bank of India, State Finance Corporations, National Bank for Agriculture and Rural Development, Export-Import Bank, etc., which operate in the money market indirectly through banks; and
- ii. Non-bank financial institutions such as the LIC, the GIC and subsidiaries, the UTI operate in this market, but only indirectly through banks, and not directly.
- iii. Quasi-Government bodies and large companies also market their short-term surplus funds available to the organized market through banks.
- iv. Cooperative credit intuitions occupy the intermediary position between organized and unorganized parts of the Indian money market. These institutions have a three tire structure. At the top, there are State cooperative banks, At the local level, there are primary credit societies and urban cooperative banks, Considering the size, methods of operations, and dealings with RBI and commercial banks, only state and Central cooperative banks should be included in the organized sector, The cooperative societies at the local level are only loosely linked with it.

Unorganized Sector:

The unorganized sector consists of indigenous banks and money lenders. It is unorganized because activities of its parts are not systematically coordinated by the RBI. The money lenders operate throughout the country, but without any link among themselves indigenous banks are somewhat better organized because they enjoy rediscount facilities from the commercial banks which, in turn, have link with the RBI. But this type of organization represents only a loose link with the RBI.

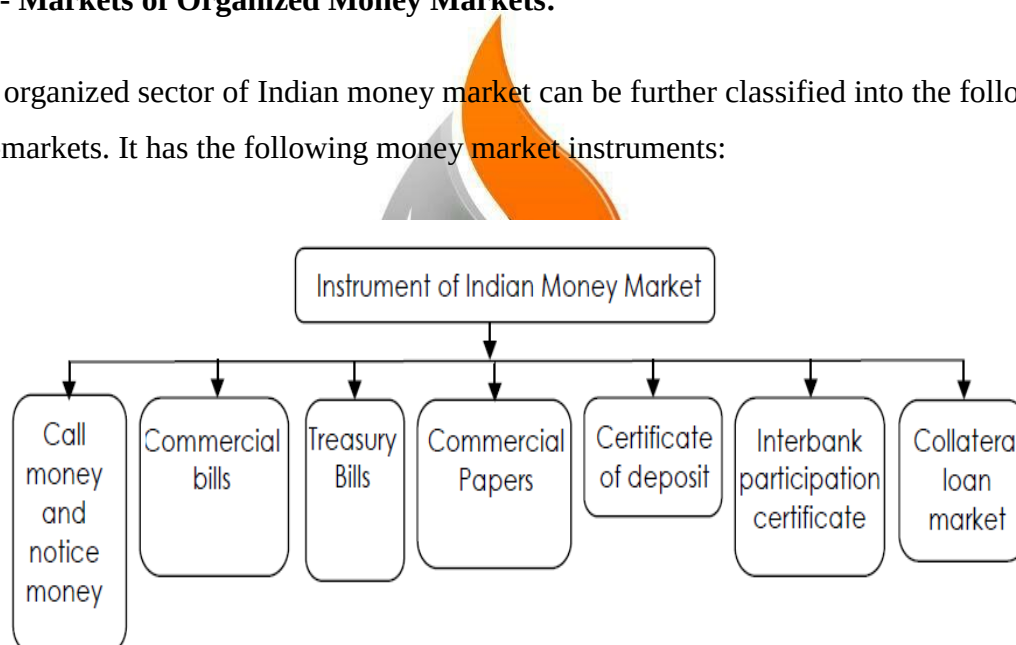
Constituents of Money market: Lenders & Borrowers

Money market is a center where short-term funds are supplied and demanded. Thus, the main constituents of money market are the lenders who supply and the borrowers who demand short-term credit.

- 1. Supply of Funds:** There are two main sources of supply of short-term 'funds in the Indian money market: (a) unorganized indigenous sector, and (b) organized modern sector.
- 2. Demand for Funds:** In the Indian money market, the main borrowers of short-term funds are : (a) Central Government, (b) State Government, (c) Local bodies, such as municipalities, village panchayats, etc., (d) traders, industrialists, farmers, exporters and importers, and (e) general public.

Sub- Markets of Organized Money Markets:

The organized sector of Indian money market can be further classified into the following sub-markets. It has the following money market instruments:



1. Call and Notice Money Market: The call and Notice Market constitutes the core of the Indian Money Market. Call money represents the amount borrowed by commercial banks from each other for short periods to meet their cash reserve requirements, Those banks whose cash reserves decline below the statutory requirement borrow from such banks which have surplus cash reserves, Funds are thus borrowed and lent for one day (call) and for a period up to 14 days (notice) without any collateral security. The market has thus two segments- (I) call or overnight market and (ii) short notice market. The rate at which funds are borrowed and bent in this market is called call money rate. The rate is determined by demand and supply.

2. Commercial Bill Market: These are Bills of exchange drawn by the seller (drawer) on the buyer (drawee and acceptor) for the value of goods sold. When once the bill is accepted by the buyer of goods (drawee), it becomes a legal document acknowledging indebtedness. It is a negotiable instrument. Such bills are drawn generally for 90 days. During the tenure of the bill, if the holder is in need of cash he can discount it with a commercial bank. The bank will deduct interest (called a negotiated discount rate) for the period the bill is yet to run. The bank will receive the face value on the due date from the drawee. Meanwhile, if the bank is in need of funds, it can rediscount it in the commercial bill rediscount market at the market-related discount rate. Banks arrange their bill portfolio in such a manner that some bills mature every day. These trade bills (commercial bills) are considered liquid assets as they can be converted into cash quickly by rediscounting.

3. Treasury Bills Market: Treasury bills are short-term promissory notes issued by the G.O.I at discount generally for a period of 91 days. They are issued to meet short-term financial needs of the Government. Since November 1986, 182 days Treasury Bills are issued by the R.B.I. Longer maturity Treasury Bills with varying maturities upto 364 days are introduced in April 1992. These bills are issued as a part of public debt operations of G.O.I. They are issued at discount and therefore do not carry interest payment obligation.

4. Commercial Paper: On the recommendations of Vaghul working Group, commercial paper is introduced in the Indian money market in January 1990. The need for the introduction of this instrument has arisen out of the changing industrial scenario. In the environment created by Liberalization policies of the Government, the industrial sector launched plans of diversification, expansion and modernization of their units. This has led to an enhanced demand for funds and to satisfy the demand C.P is introduced. Commercial papers are unsecured promissory notes issued by corporate entities to raise resources for their short-term needs instead of borrowing from banks. It is a certificate evidencing an unsecured corporate debt of short maturity. It represents a promise by the borrowing company to repay loan at a specified date.

5. Certificate of Deposit: The RBI introduced the Certificates of Deposits Scheme in June 1989. The object is to further widen the range of money market instruments and to give investors further opportunity of deploying their short-term funds. C.D's are deposit receipts issued by banks against deposits kept by individuals, companies, P.S.U.s and other

institutions. Non-resident Indian can also subscribe to C.Ds but only on a non-repatriation basis.

6. Inter-bank Term Money Market: This is a market in which banks alone both commercial and co-operative banks participate. They borrow and lend funds from and to each other for a period over 14 days and generally upto 90 days. No collateral security is insisted upon. The rates of interest are market determined. Deposited receipts are exchanged. As per the Indian Banks Association (I.B.A) rules, lenders cannot prematurely call back these loans. Hence, this instrument is not liquid.

7. Collateral Loan Market: It deals in collateral loans-loans backed up security. In this market, commercial banks provide loans against the Government securities and bonds.

Defects of Indian Money Market

The Indian money market is inadequately developed, loosely organized and suffers from many weaknesses. Major defects are discussed below:-

1. Dichotomy between Organized and Unorganized Sectors: The most important defect of the Indian money market is its division into two sectors: (a) the organized sector and (b) the unorganized sector. There is little contract, coordination and cooperation between the two sectors. In such conditions it is difficult for the Reserve Bank to ensure uniform and effective implementations of its monetary policy in both the sectors.

2. Predominance of Unorganized Sector: Another important defect of the Indian money market is its predominance of unorganized sector. These indigenous bankers, which constitute a large portion of the money market, remain outside the organized sector. Therefore, they seriously restrict the Reserve Bank's control over the money market.

3. Wasteful Competition: Wasteful competition exists not only between the organized and unorganized sectors, but also among the members of the two sectors. The relation between various segments of the money market is not cordial; they are loosely connected with each other and generally follow separatist tendencies. Similarly, competition exists between the Indian commercial banks and foreign banks.

4. Absence of All- Indian Money Market: Indian money market has not been organized in to a single integrated all-Indian market. It is divided into small segments mostly catering to the local financial needs. For examples, there is little contract between the money market in the bigger cities. Like, Mumbai, Chennai, and Kolkata and those in smaller towns.

5. Inadequate Banking Facilities: Indian money market is inadequate to meet the financial needs of the economy. Although there has been rapid expansion of bank branches in recent years particularly after the nationalization of banks, yet vast rural areas still exist without banking facilities. As compared to the size and population of the country, the banking institutions are not enough.

6. Shortage of capital: Indian money market generally suffers from the shortage of capital funds. The availability of capital in the money market is insufficient to meet the needs of industry and trade in the county.

7. Seasonal Shortage of Funds: A major drawback of the Indian money market is the seasonal stringency of credit and higher interest rates during a part of the year. On the contrary, during the slack season, from July to October, the demand for credit and the rate of interest decline sharply.

8. Diversity of Interest Rates: Another defect of Indian money market is the multiplicity and disparity of interest rates. The interest rates also differ in various centers like Mumbai, Kolkata etc. Variations in the interest rate structure are largely due to the credit immobility because of inadequate, costly and time-consuming means of transferring money. Disparities in the interest rates adversely affect the smooth and effective functioning of the money market.

9. Absence of Bill Market: The existence of a well- organized bill market is essential for the proper and efficient working of money market. Unfortunately, in spite of the serious efforts made by the reserve bank of India, the bill market in India has not yet been fully developed. The short-term bills form a much smaller proportion of the bank finance in India as compared to that in the advanced countries.

Measures to Improve Indian money market:

In view of the various defects in the Indian money market, the following suggestions have been made for its proper development:

- (i) The activities of the indigenous banks should be brought under the effective control of the Reserve Bank of India.
- (ii) Hundies used in the money market should be standardized and written in the uniform manner in order to develop an all-India money market.
- (iii) Banking facilities should be expanded especially in the unbanked and neglected areas.
- (iv) Discounting and rediscounting facilities should be expanded in a big way to develop the bill market in the country.
- (v) For raising the efficiency of the money market, the number of the clearing houses in the country should be increased and their working improved.
- (vi) Adequate and less costly remittance facilities should be provided to the businessmen to increase the mobility of capital.
- (vii) Variations in the interest rates should be reduced.



BANKS - CATEGORY	LEGAL FRAME WORK
State Bank of India	State Bank of India Act, 1955
SBI Associate Banks	State Bank (Subsidiary Banks) Act, 1959
Nationalised Banks - 1969	Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970
Nationalised Banks - 1980	Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980
Regional Rural Banks	Regional Rural Banks Act, 1976
Private Sector Banks	Indian Companies Act, 1986
Co-operative Banks	Co-operative Societies Acts (State/Central) and Banking Laws (Applicable to Cooperative Societies) Act, 1965
	Banking Laws (Application to Co-operative Societies Act, 1965)

Capital Market

Definition: Capital Market, is used to mean the market for long term investments, that have explicit or implicit claims to capital. Long term investments refers to those investments whose lock-in period is greater than one year.

In the capital market, both equity and debt instruments, such as equity shares, preference shares, debentures, zero-coupon bonds, secured premium notes and the like are bought and sold, as well as it covers all forms of lending and borrowing.

Capital Market is composed of those institutions and mechanisms with the help of which medium and long term funds are combined and made available to individuals, businesses and government. Both private placement sources and organized market like securities exchange are included in it.

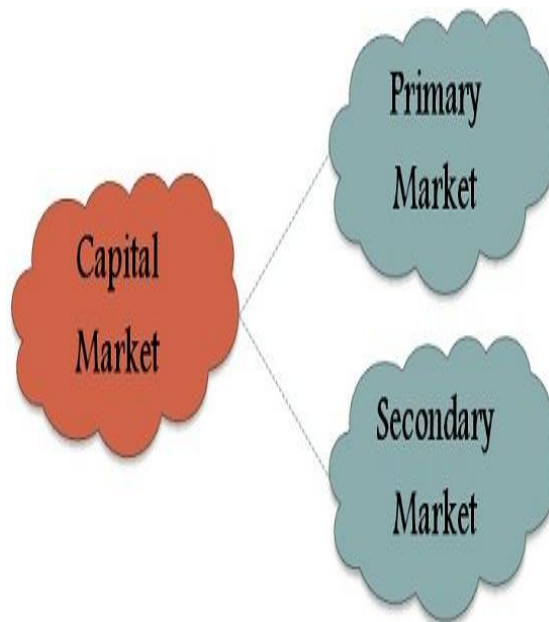
Functions of Capital Market

- 
- Mobilization of savings to finance long term investments.
 - Facilitates trading of securities.
 - Minimization of transaction and information cost.
 - Encourage wide range of ownership of productive assets.
 - Quick valuation of financial instruments like shares and debentures.
 - Facilitates transaction settlement, as per the definite time schedules.
 - Offering insurance against market or price risk, through derivative trading.
 - Improvement in the effectiveness of capital allocation, with the help of competitive price mechanism.

Capital market is a measure of inherent strength of the economy. It is one of the best source of finance, for the companies, and offers a spectrum of investment avenues to the investors, which in turn encourages capital creation in the economy.

Types of Capital Market

The capital market is bifurcated in two segments, primary market and secondary market:



1. **Primary Market:** Otherwise called as New Issues Market, it is the market for the trading of new securities, for the first time. It embraces both initial public offering and further public offering. In the primary market, the mobilisation of funds takes place through prospectus, right issue and private placement of securities.
2. **Secondary Market:** Secondary Market can be described as the market for old securities, in the sense that securities which are previously issued in the primary market are traded here. The trading takes place between investors, that follows the original issue in the primary market. It covers both stock exchange and over-the counter market.

Capital market improves the quality of information available to the investor regarding the investment. Add to that, it plays a crucial role in encouraging the adoption of rules of corporate governance, which backs the trading environment. It includes all the processes that help in the transfer of already existing securities.

BASEL

The Basel Committee on Banking Supervision (BCBS) is a committee which was set up by the Central Bank Governors of a group of ten countries, to address international issues relating to the banking supervision. The Basel Committee on Banking Supervision in 1988 came out with a Capital Accord for banks, covering the areas of risks in respect of banks’

assets and liabilities in the balance sheet and off balance sheet exposures. Basel Norms categorized these risks broadly into three viz, (1) Credit Risk (2) Market Risk and (3) Operational Risk

Why BASEL?

- **2007-08:** Subprime crisis in USA, after their banks loaned money to “subprime” borrowers i.e. people without capacity to repay the loan.
- The resultant housing bubble and its collapse, led to economic downturn throughout the world.
- To prevent such crisis in future, there is need for common banking regulation across globe. BASEL norms aim to achieve this.

What is BASEL?

- BASEL is a city of Switzerland.
- BASEL norms were initially designed in 1988. Later updated in 2004 and 2011. They prescribe ‘safe-lending’ norms to banks.
- At present we are at BASEL-III norms stage.

What are BASEL Capital adequacy requirements (CAR)?

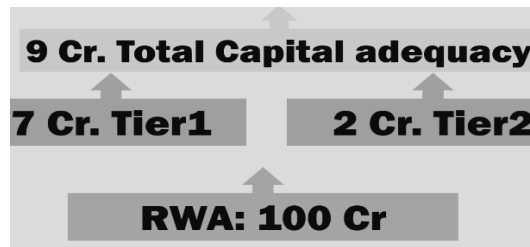
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Let’s understanding using a technically incorrect example. First a bank needs to calculate its “Risk weighted assets”.

Numbers only for illustration

Product	x risk*	total amount loaned
home loan	30%	20 crores
commercial loan	60%	30 crores
G-sec	10%	60 crores
total risk weighted assets (RWA)	100%	100 crores

- To sustain this loan business, a Bank needs to have ‘sufficient’ capital under BASEL norms. For example, if a bank has total risk weighed assets worth Rs.100 crore then...
- It needs to have total capital adequacy of 9 crore rupees.
- out of which, 7 crore in tier-1 and 2 crores in tier-2 capital.



To express this in a formula
Basel Capital adequacy requirement (CAR)= 9% of RWA (Risk weighted assets)
 OR

$$\text{BASEL CAR} = [7\% \text{ of RWA in T1}] + [2\% \text{ of RWA in T2}]$$

Classification of Bank capital	
Tier-1	Tier-2
common shares	Debts (bonds)
preferential shares	hybrid instruments such as “optionally fully convertible debentures”
highest liquidity i.e. can be sold easily to gather cash and ward off any crisis.	less liquid than Tier-1 capital
	This capital is further classified into Upper T2 and lower T2. But such technicalities are not asked in competitive exams or generic interviews so ignore it.

- Anyways, point being- if a bank wants to loan 100 crore money (risk weight assets) then it ought to have 9 crore as “total capital adequacy”.
- if not, then they need to arrange money by borrowing via debt or equity route.

- Public sector banks of India (PSB) need total 2.4 lakh crore rupees to comply with BASEL-III norms.

BASEL-III norms

- These were to be implemented from March 2018, as per initial order of RBI
- but Indian banks showed inability to raise so much capital in so little time
- Hence RBI governor Raghuram Rajan extended the deadline to March 2019.
- Public sector banks also hoped that Government of India would give them necessary capital from tax payer's money
- But the new Finance minister Arun Jaitley has declined. In Budget 2014, he announced that banks themselves will have to raise money by selling shares to public, in a phase manner. Although Government will continue to remain the majority shareholder.

Criticism of BASEL norms

1. Reserve bank of India, already has sufficient “backup” mechanisms to prevent banking crisis in India- such as Cash reserve ratio (CRR), Statutory liquidity ration (SLR), all banks are required to make fortnightly reporting to RBI about their finance and operations and so on.
2. One shoe doesn't fit all. Just because American Banks were so imprudent in their functioning and ran into trouble, doesn't mean WE the Indian banks need be so overcautious and keep so much of money aside for 'safety'. It could be given to the needy customers and businessmen.

RISK MANAGEMENT

A risk arises on account of an uncertain event, which might result in a loss or gain to the parties associated with such risk. Even though the risk is an independent event, invariably risks are interlinked in the sense; one risk may lead to other risks as well.

Risk Management – Important Features

1. Risk management policies should be approved by the board. It should cover all the required guidelines and directives of the regulators and applicable legal frame work
2. There should be a good support from the Information Technology wing for creating an integrated system whereby an effective and efficient MIS would be an integral part of the risk management
3. There should be clear demarcation of functions and authority levels to ensure better internal control systems (ex: front office, mid office and back office of an integrated treasury)
4. An effective communication system coupled with the training programs
5. One of the risk mitigation measures is to setup appropriate limits for various aspects like counter party limit, country limit, currency limit, overnight and intraday limits, stop loss limit, individual and group exposure limits etc.
6. Inbuilt checking and balancing systems, such as input and output controls, access control to the computer systems, and sensitive areas of the banks
7. Apart from review by the ALCO members, a periodical review and evaluation system should be in place. (Asset-Liability Management Committee (ALCO) is a strategic decision making body, formulating and overseeing the function of asset liability management (ALM) of a bank. ALCO is headed by the Managing Director or the Chief Executive Officer.)



Risk Management is a methodology that helps managers make best use of their available resources. The process consists of important steps like:

- i. **Identification of risks:** Identify the types of risks are associated with the banking business and operations. Define the types of risk, with special reference to the goals and objectives of the organization. Based on the past experience and future forecasts, risks can be identified and classified in to different levels like High, Medium and Low levels
- ii. **Analyzing the risks:** Risks arise out of many factors like, PESTEL factors, Micro and Macroeconomic policies, ineffective internal control systems, speculation etc., Risks can be identified by means of using various analysis like financial, technical, trend and sensitivity analysis based on probability, trend , etc.,

- iii. **Evaluating the risks:** The risk may be evaluated by following the Regulators guidelines and directives and also based on past experiences as well. At the time of evaluation, proper weightages needs to be assigned for different types of risks as per banks' risk management policies, such as, risk category, cost associated in managing such risks and also the impact of such risks.
- iv. **Monitor and review:** Monitoring and review process is an important segment in risk management. An effective monitoring system would assist bank management to identify or forecast risks to enable it to strengthen risk management with more controls to manage the risks which might arise from their business models and their exposure to various markets, across borders. In identifying, prioritizing and treating risks, organizations make assumptions and decisions based on situations that are subject to change, (e.g., the business environment, trading patterns or government policies).
- v. **Mitigation of risks:** One of the main objectives of the Risk Management is to ensure that risks are either avoided or minimized. While it is agreed that not all risks can be avoided, good risk management practices should create an effective system of mitigation of risks.

Risk Management under Basel I

Under the Basel I Accord, only the credit risk factor was considered and the minimum requirement of capital funds was fixed at 8 per cent of the total risk weighted assets. In India, banks are required to maintain a minimum of 9 percent (Capital to Risk Weighted Asset Ratio – CRAR) on an ongoing basis.

Risk Management under Basel II

The Second Accord brought in significant changes in risk management in banks. The Basel II accord introduced a new approach based on the three pillars:

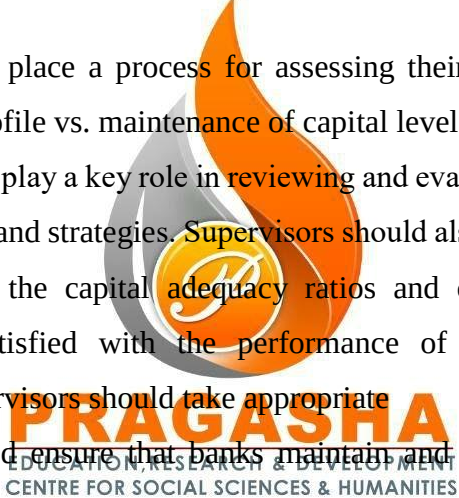
Pillar I: Minimum Capital Requirements:

The minimum capital requirement should be calculated based on three risks viz., (a) Credit Risk – (i) Standardized Approach (ii) Internal Ratings Based Approach (b) Operational Risk and (c) Market Risk

Pillar II: Supervisory Review Process:

This pillar addresses the issues like the key aspects of supervisory review, risk management guidance and transparency and accountability. It also covers the treatment of interest rate risk in the banking book, credit risk (stress testing, credit concentration risk etc) operational risk, enhanced cross border risks.

The committee had identified four key principles of supervisory review:

- 
- i. Banks should have in place a process for assessing their overall capital adequacy in respect of their risk profile vs. maintenance of capital level
 - ii. (ii) Supervisors should play a key role in reviewing and evaluating banks' internal capital adequacy assessments and strategies. Supervisors should also be satisfied with the banks' abilities in managing the capital adequacy ratios and comply with the regulators' guidelines. If not satisfied with the performance of banks in their compliance requirements, the supervisors should take appropriate
 - iii. (iii) Supervisors should ensure that banks maintain and operate above the minimum regulatory capital ratios
 - iv. (iv) Supervisors should intervene at an early stage, to prevent capital level from falling below the minimum levels required and take quick remedial measures

Pillar III – Market Discipline:

As part of an effective risk management, banks are expected to disclose important information. Such market discipline can contribute to a safe and sound banking environment. These disclosures would assist various stakeholders to review and understand the status of the banks' operations and strategies in a competitive business environment. These disclosures would assist the investors to make their investment decisions

RISK MANAGEMENT UNDER BASEL III

As per Basel Committee on Banking Supervision (BCBS), Basel III reforms have been introduced to improve the banking sector's ability to absorb shocks arising from financial and economic stress, thus reducing the risk spillover from the financial sector to the real economy.

Basel III norms address the following:

- (a) At micro level, through prudential regulation to strengthen the individual banking institution's ability to handle crisis in the period of stress
- (b) At macro level, through prudential regulation to address system wide risks across banking sector as well as the pro-cyclical amplification of these risks over a period of time
- (c) Raising the quality and level of capital to ensure that the banks are better equipped to absorb losses on both, a going concern basis and a gone concern basis
- (d) Increase the level of risk coverage of the capital framework by introducing leverage ratio to serve as a backdrop to the risk-based capital
- (e) Raise the standards for supervisory review (Pillar 2) and public disclosures (Pillar 3)
- (f) The capital buffers- capital conservation buffer and the countercyclical buffer- are expected to protect the banking sector from the periods of excess credit growth.

The BASEL III capital regulations continue to be based on three-mutually reinforcing Pillars viz. minimum capital requirements, supervisory review of capital adequacy, and market discipline, of BASEL II.

In India guidelines on Basel III capital regulation have been implemented from April 1, 2013 in a phased manner. *To ensure smooth transition to BASEL III, appropriate transitional arrangements have been made for meeting the minimum BASEL III capital Ratios, full regulatory adjustments to the components of capital, etc. Consequently, BASEL III capital regulations would be fully implemented as on March 31, 2018.*

Guidelines on Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools under Basel III:

The Basel III Framework on Liquidity Standards includes Liquidity Coverage Ratio (LCR), Net Stable Funding Ratio (NSFR) and liquidity risk monitoring tools. RBI's guidelines included enhanced guidance on liquidity risk governance, and measurement, monitoring and reporting to the Reserve Bank on liquidity positions. The Basel III liquidity standards were subject to an observation period/revision by the Basel Committee with a view to addressing any unintended consequences that the standards may have for financial markets, credit extension and economic growth.

The Basel Committee has issued guidelines on the Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools in January 2013, and is in the process of finalizing the NSFR and disclosure requirements. The LCR is to be implemented from January 1, 2015 and the NSFR from January 1, 2018. The Reserve Bank will issue the final guidelines on Basel III liquidity standards and liquidity risk monitoring tools, taking into account the revisions by the Basel Committee.

NON-PERFORMING ASSETS(NPA)

NPAs definition by Reserve Bank of India (RBI): An asset, including a leased asset, becomes nonperforming when it ceases to generate income for the bank.

Technical definition by RBI on NPA on different cases



NPA is a loan or an advance where...

- Interest and/ or installment of principal remain overdue for a period of more than 90 days in respect of a term loan.
- The account remains 'out of order' in respect of an Overdraft/Cash Credit (OD/CC).
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.
- The installment of principal or interest thereon remains overdue for two crop seasons for short duration crops.
- The installment of principal or interest thereon remains overdue for one crop season for long duration crops.

- The amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction undertaken in terms of guidelines on securitisation dated February 1, 2006.
- In respect of derivative transactions, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

Categories of Non-Performing Assets (NPAs)

Based upon the period to which a loan has remained as NPA, it is classified into 3 types:

Categories of NPAs	Criteria
Substandard Assets	An asset which remains as NPAs for less than or equal to 12 months.
Doubtful Assets	An asset which remained in the above category for 12 months.
Loss Assets	Asset where loss has been identified by the bank or the RBI, however there may be some value remaining in it. Therefore loan has not been completely written off.

How serious is India's NPA issue?

- More than Rs. 7 lakh crore worth loans are classified as Non-Performing Loans in India. This is a huge amount.
- The figure roughly translates to near 10% of all loans given.
- This means that about 10% of loans are never paid back, resulting in substantial loss of money to the banks.
- When restructured and unrecognised assets are added the total stress would be 15-20% of total loans.
- NPA crisis in India is set to worsen.
- Restructuring norms are being misused.
- This bad performance is not a good sign and can result in crashing of banks as happened in the sub-prime crisis of 2008 in the United States of America.

- Also, the NPA problem in India is worst when comparing other emerging economies in BRICS.

What can be the possible reasons for NPAs?

- Diversification of funds to unrelated business/fraud.
- Lapses due to diligence.
- Business losses due to changes in business/regulatory environment.
- Lack of morale, particularly after government schemes which had written off loans.
- Global, regional or national financial crisis which results in erosion of margins and profits of companies, therefore, stressing their balance sheet which finally results into non-servicing of interest and loan payments. (For example, the 2008 global financial crisis).
- The general slowdown of entire economy for example after 2011 there was a slowdown in the Indian economy which resulted in the faster growth of NPAs.
- The slowdown in a specific industrial segment, therefore, companies in that area bear the heat and some may become NPAs.
- Unplanned expansion of corporate houses during boom period and loan taken at low rates later being serviced at high rates, therefore, resulting into NPAs.
- Due to mal-administration by the corporates, for example, willful defaulters.
- Due to misgovernance and policy paralysis which hampers the timeline and speed of projects, therefore, loans become NPAs. For example Infrastructure Sector.
- Severe competition in any particular market segment. For example ,Telecom sector in India.
- Delay in land acquisition due to social, political, cultural and environmental reasons.
- A bad lending practice which is a non-transparent way of giving loans.
- Due to natural reasons such as floods, droughts, disease outbreak, earthquakes, tsunami etc.
- Cheap import due to dumping leads to business loss of domestic companies. For example Steel sector in India.

What is the impact of NPAs?

- Lenders suffer lowering of profit margins.
- Stress in banking sector causes less money available to fund other projects, therefore, negative impact on the larger national economy.
- Higher interest rates by the banks to maintain the profit margin.
- Redirecting funds from the good projects to the bad ones.
- As investments got stuck, it may result in it may result in unemployment.
- In the case of public sector banks, the bad health of banks means a bad return for a shareholder which means that government of India gets less money as a dividend. Therefore it may impact easy deployment of money for social and infrastructure development and results in social and political cost.
- Investors do not get rightful returns.
- Balance sheet syndrome of Indian characteristics that is both the banks and the corporate sector have stressed balance sheet and causes halting of the investment-led development process.
- NPAs related cases add more pressure to already pending cases with the judiciary.

What are the various steps taken to tackle NPAs?

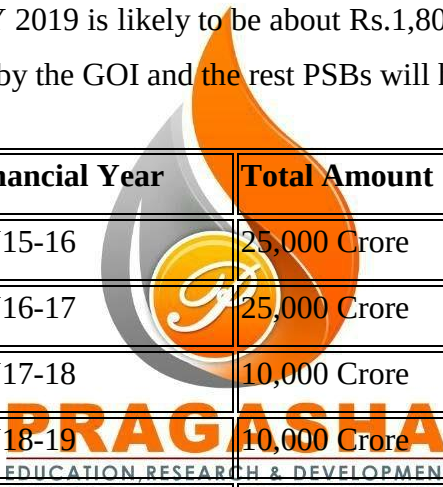
NPAs story is not new in India and there have been several steps taken by the GOI on legal, financial, policy level reforms. In the year 1991, **Narsimham committee** recommended many reforms to tackle NPAs. Some of them were implemented.

- **The Debt Recovery Tribunals (DRTs), 1993:** To decrease the time required for settling cases. They are governed by the provisions of the Recovery of Debt Due to Banks and Financial Institutions Act, 1993. However, their number is not sufficient therefore they also suffer from time lag and cases are pending for more than 2-3 years in many areas.
- **Credit Information Bureau, 2000:** A good information system is required to prevent loan falling into bad hands and therefore prevention of NPAs. It helps banks by maintaining and sharing data of individual defaulters and willful defaulters.
- **Lok Adalats, 2001:** They are helpful in tackling and recovery of small loans however they are limited up to 5 lakh rupees loans only by the RBI guidelines issued in 2001. They are positive in the sense that they avoid more cases into the legal system.

- **Compromise Settlement, 2001:** It provides a simple mechanism for recovery of NPA for the advances below Rs. 10 Crores. It covers lawsuits with courts and DRTs (Debt Recovery Tribunals) however willful default and fraud cases are excluded.
- **SARFAESI Act, 2002:** The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 – The Act permits Banks / Financial Institutions to recover their NPAs without the involvement of the Court, through acquiring and disposing of the secured assets in NPA accounts with an outstanding amount of Rs. 1 lakh and above. The banks have to first issue a notice. Then, on the borrower's failure to repay, they can:
 - Take ownership of security and/or
 - Control over the management of the borrowing concern.
 - Appoint a person to manage the concern.
 - Further, this act has been amended last year to make its enforcement faster.
- **ARC (Asset Reconstruction Companies) :** The RBI gave license to 14 new ARCs recently after the amendment of the SARFAESI Act of 2002. These companies are created to unlock value from stressed loans. Before this law came, lenders could enforce their security interests only through courts, which was a time-consuming process.
- **Corporate Debt Restructuring, 2005:** It is for reducing the burden of the debts on the company by decreasing the rates paid and increasing the time the company has to pay the obligation back.
- **5:25 rule, 2014:** Also known as, **Flexible Structuring of Long Term Project Loans to Infrastructure and Core Industries.** It was proposed to maintain the cash flow of such companies since the project timeline is long and they do not get the money back into their books for a long time, therefore, the requirement of loans at every 5-7 years and thus refinancing for long term projects.
- **Joint Lenders Forum, 2014:** It was created by the inclusion of all PSBs whose loans have become stressed. It is present so as to avoid loan to same individual or company from different banks. It is formulated to prevent the instances where one person takes a loan from one bank to give a loan of the other bank.
- **Mission Indradhanush, 2015:** The Indradhanush framework for transforming the PSBs represents the most comprehensive reform effort undertaken since banking nationalization

in the year 1970 to revamp the Public Sector Banks (PSBs) and improve their overall performance by **ABCDEFGH**.

- (a)**A-Appointments:** Based upon global best practices and as per the guidelines in the companies act, separate post of Chairman and Managing Director and the CEO will get the designation of MD & CEO and there would be another person who would be appointed as non-Executive Chairman of PSBs.
- (b)**B-Bank Board Bureau:** The BBB will be a body of eminent professionals and officials, which will replace the Appointments Board for appointment of Whole-time Directors as well as non-Executive Chairman of PSBs
- (c)**C-Capitalization:** As per finance ministry, the capital requirement of extra capital for the next four years up to FY 2019 is likely to be about Rs.1,80,000 crore out of which 70000 crores will be provided by the GOI and the rest PSBs will have to raise from the market.



Financial Year	Total Amount
FY15-16	25,000 Crore
FY16-17	25,000 Crore
FY17-18	10,000 Crore
FY18-19	10,000 Crore
Total	70,000 Crore

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- (d)**D-DEstressing:** PSBs and strengthening risk control measures and NPAs disclosure.
- (e)**E-Employment:** GOI has said there will be no interference from Government and Banks are encouraged to take independent decisions keeping in mind the commercial the organizational interests.
- (f)**F-Framework of Accountability:** New KPI(key performance indicators) which would be linked with performance and also the consideration of ESOPs for top management PSBs.
- (g)**G-Governance Reforms:** For Example, Gyan Sangam, a conclave of PSBs and financial institutions. Bank board Bureau for transparent and meritorious appointments in PSBs.

- **Strategic debt restructuring (SDR), 2015:** Under this scheme banks who have given loans to a corporate borrower gets the right to convert the complete or part of their loans into equity shares in the loan taken company. Its basic purpose is to ensure that more stake of promoters in reviving stressed accounts and providing banks with enhanced capabilities for initiating a change of ownership in appropriate cases.
- **Asset Quality Review, 2015:** Classify stressed assets and provisioning for them so as to secure the future of the banks and further early identification of the assets and prevent them from becoming stressed by appropriate action.
- **Sustainable structuring of stressed assets (S4A), 2016:** It has been formulated as an optional framework for the resolution of **largely stressed accounts**. It involves the determination of sustainable debt level for a stressed borrower and bifurcation of the outstanding debt into sustainable debt and equity/quasi-equity instruments which are expected to provide upside to the lenders when the borrower turns around.
- **Insolvency and Bankruptcy code Act, 2016:** It has been formulated to tackle the **Chakravyuaha Challenge** (Economic Survey) of the exit problem in India. The aim of this law is to promote entrepreneurship, availability of credit, and balance the interests of all stakeholders by consolidating and amending the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner and for maximization of value of assets of such persons and matters connected therewith or incidental thereto.
- **Public ARC vs. Private ARC, 2017:** This debate is recently in the news which is about the idea of a Public Asset Reconstruction Companies (ARC) fully funded and administered by the government as mooted by this year's Economic Survey Vs. the private ARC as advocated by the deputy governor of RBI Mr. Viral Acharya. Economic survey calls it as PARA (Public Asset Rehabilitation Agency) and the recommendation is based on the similar agency being used during the East Asian crisis of 1997 which was a success.
- **Bad Banks, 2017:** Economic survey 16-17, also talks about the formation of a bad bank which will take all the stressed loans and it will tackle it according to flexible rules and mechanism. It will ease the balance sheet of PSBs giving them the space to fund new projects and continue the funding of development projects.

The need of the hour to tackle NPAs is some urgent remedial measures. This should include:

- Technology and data analytics to identify the early warning signals.
- Mechanism to identify the hidden NPAs.
- Development of internal skills for credit assessment.
- Forensic audits to understand the intent of the borrower.

E- BANKING

Over the years, especially in the later part of the 20th century, the Indian Banking Sector has undergone fast growth and with the advent of technological changes, Indian banks are adopting to the new environment. The two successive Committees on Computerization (Rangarajan Committees) were responsible for bank computerization in India. Over the years led by the initiatives of the Reserve Bank of India, banks in India have witnessed lot of changes into their banking operations duly supported by IT and communication revolution.

Some important areas where the IT plays important roles are:

- Funds Transfer mechanism: ECS, EFT, RTGS, NEFT
- Clearing House operations: MICR, CTS
- Innovative on line e- banking services: Tele banking, Mobile banking, SMS banking, Credit/ Debit Cards, ATMs, Internet banking, Core Banking Solutions, etc.

Communication Networks in Banking System

As per the recommendations of the Saraf Committee, the Reserve Bank of India has set up a country wide data communication network for banks linking major centers of the country, known as INFINET (Indian Financial Network) and this network uses satellite communication with very small aperture terminals (VSATs) as earth stations.

VSAT network is a single closed user group network for the exclusive use of banks and other financial institutions. The VSATs are owned by individual banks and the RBI. The hub is owned by the RBI and the Institute for Development and Research in Banking Technology

(IDRBT). Satellite services based on VSAT technology can establish reliable links to all sites. The central hub monitors and controls the flow of network traffic

SWIFT

Society for Worldwide Inter-bank Financial Telecommunications (SWIFT) is a co-operative non-profit making organization established under Belgian law with its head quarters at Brussels. SWIFT is wholly owned by its member banks. SWIFT is a paperless message transmission system.

SWIFT – important features:

- Operates on 24x7 basis throughout the year
- All messages are transmitted to any part of the world immediately
- Message formats are standardized
- Information is confidential and is protected against unauthorized disclosure
- SWIFT assumes financial responsibility for the accuracy and timely delivery

SWIFT and banks:

- SWIFT has become an integral part of banking system. SWIFT assist member banks
- SWIFT transmit authenticated financial and non financial messages
- SWIFT with its well-standardized and structured message formats have been offering a reliable system of message transmission
- Banks use SWIFT platform to for transmission of financial and non financial messages covering international finance (settlement of forex deals), international trade (advising of LCs, amendments to LCs etc,)

AUTOMATED CLEARING SYSTEMS

- **Clearing House Inter-bank Payment System (CHIPS):** This is a clearing system run by New York clearing house. The financial transactions such as – foreign and domestic trade services, international loans, syndicated loans, foreign exchange trade settlements,

are carried out through CHIPS. The CHIPS have a direct interface with the SWIFT system.

- **Clearing House Automated Payment System (CHAPS):** CHAPS is an automated system set up in UK which ensures immediate settlement of payments.
- **Clearing House Automated Transfer System (CHATS):** CHATS provide the inter-bank transfer facilities in Hong Kong. CHATS provide same day inter-bank settlement, instant order confirmation and enquiry facilities. The integrity of message transmission is carried out through authentication and encryption techniques.

Electronic Fund Management

IT revolution has paved way for banks to implement different systems to handle funds management in banks. This methodology is collectively recognized as Electronic Fund Management.

Electronic Clearing System (ECS): One of the earliest electronic forms of funds transfer is the Electronic Clearing System. ECS is a retail funds transfer system to effect payments (utility bills, dividends, interest, etc) ECS helps corporates, government departments, public sector undertakings, utility service providers to receive and/or pay bulk payments. ECS is divided into ECS (credit) and ECS (debit).

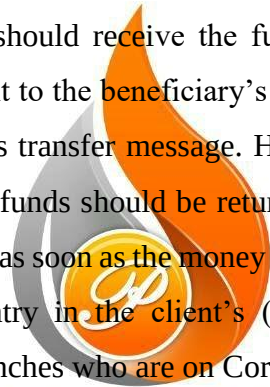


- ECS (debit) is generally used by utility companies like electricity companies, telephone companies and other to receive the bill payments directly from bank accounts of their clients.
- ECS (Credit) can facilitate payment to various clients like dividend warrants, maturity values of Annuities.

Real Time Gross Settlement (RTGS): RTGS is an electronic payment system, where payment instructions are processed on a 'continuous' or 'REAL TIME' basis and settled on a 'GROSS' or 'individual' basis without netting the debits against credits. The RTGS: Special features are:

- a) Real Time Gross Settlement helps banks to settle interbank and forex settlements

- b) It also helps banks in handling big ticket funds transfers
- c) Since RTGS it is routed through RBI platform, the credit risk is minimized (this is one of the main advantages in settlement of funds)
- d) Unlike in case of cheque clearance, the drawer of the cheque cannot enjoy the float time (the date of issuance of cheque and the date on which it is received in inward clearing and debited by his banker). However, in the case of RTGS, the remitter's account is debited first and then only the funds are transferred
- e) If all relevant details such as the beneficiary's name, account number, IFSC code of the receiving branch, name of the beneficiary bank, etc., are correctly furnished it would assist the remitting bank to effect the transfer quickly
- f) As the name RTGS suggests, the transfer mechanism works on real time and, therefore, the beneficiary branch/bank should receive the funds immediately. The beneficiary's branch/bank should give credit to the beneficiary's account immediately or latest within 2 hours of receiving the funds message. However, in case the funds cannot be credited for any reason, such funds should be returned to the originating branch within two hours. In such a situation, as soon as the money is returned, the remitting bank should reverse the original debit entry in the client's (remitter's) account. This system is applicable between banks/branches who are on Core Banking Solutions (CBS)



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National Electronic Funds Transfer (NEFT): NEFT is a system similar to RTGS with certain differences. RTGS handles big ticket transactions, whereas NEFT handles smaller size transactions. Most branches are using this facility to transfer funds in an efficient manner. Once the applicant for the transfer of funds furnishes full and correct details (correct account details means correct name of the beneficiary, the correct account number, the branch and bank of the beneficiary, and the correct IFS code, etc.) funds can be transferred to the beneficiary's account by the remitting bank. Transfer of funds through NEFT is safe, quick. It reduces the paper work and is cost effective. NEFT is an innovative electronic media for effecting transfer of funds. Special features of NEFT are:

1. NEFT is a funds transfer system which enables a customer of a bank to transfer funds to another customer of another bank having account with any participating bank
2. NEFT allows both intra and inter-bank funds transfer within a city and across cities

3. Since it is in the form of e transfer, without any physical movement of instruments, funds can be transferred quickly
4. The beneficiary customer gets funds in his account on the same day or at the earliest on the next day depending upon the time of settlement
5. Both the originating and destination bank branches should be on NEFT platform
6. The correct details of IFSC, beneficiary's name, account numbers, etc., should be furnished to the originating bank.
7. The originating bank branch can keep track of the status of the NEFT transaction.
8. In case for any reason the destination branch is not able to afford credit to the beneficiary's account, destination branch/bank have to return the funds to the originating bank within two hours of completion of the batch through which the transaction was processed
9. It is not only easy method of transfer of funds, but also enables the remitters to have user friendly and cost effective transfer of funds

Indian Financial System Code (IFSC): IFSC is an alpha-numeric code that identifies a bank-branch participating in the RTGS/NEFT system. IFSC has 11 digit code and the first four alpha characters represents the bank, the 5th code is 0 (zero), which is reserved for future use and the last six digits are numeric characters represents the branch. Correct IFSC code is essential for identifying the beneficiary's branch and bank as destination for funds transfers. E.g. Syndicate Bank Cuffe Parade Branch, Mumbai- SYNB0005087



Automated Teller Machines (ATMs): ATMs are used as a channel for cash management of individual customers. ATMs can be accessed by ATM card, debit or credit cards. To have access the customer (the card holder) needs to use his Personal Identification Number (PIN) issued by his/her banker and access password. ATMs generally used for cash deposit and withdrawals, they can also be used for payment of utility bills, funds transfer thereby ATMs serve as a channel for electronic funds management. Requests for new cheque book and statement of accounts can also be given through ATMs.

White Label ATMs- RBI has vide notifications dated 20th June, 2012, permitted non-banking entities to set up or start ATMs which are called White Label ATMs (WLA). From such ATMs customers of any bank will be able to withdraw money, takeout statement, change PIN

etc. These WLAs will not display logo of any bank. However, WLA operator has been permitted to display advertisements, and offer value added services as per regulations in force. While WLA operator is entitled to receive a fee from the banks for use of ATM resources by their customers, WLAs are not permitted to charge Bank customers directly for use of WLA.

Internet Banking: Internet banking one of the popular e-banking modes has changed the banking operations and offer virtual banking services to the clients on 24 x 7 basis. It is also called as convenient banking, since the customer (account holder) can have access to his bank account from anywhere at any time, through the bank's web site.

The customer is allowed online access to account details and payment and funds transfer facilities. Net banking services of a bank can be accessed through a Personal Identification Number (PIN) and access password as in the case of ATMs. In net banking the advantage for the bank customer is that funds can be transferred from the client's bank account to another account with the same bank or another bank through NEFT/RTGS. Another method of funds transfer facility is online payment of taxes. Bank customer can pay various taxes like income tax, service tax, etc.; Net banking can be used as a channel by the customer to pay the utility bills (electricity bills, telephone bills, etc) on line. Customers can make use of net banking to pay the insurance premiums and similar other payments.



Core Banking Solutions (CBS): Core Banking Solutions has helped banks to offer better customer service. It has also reduced the time and increased the efficiency. The Core Banking Solutions mainly work on the support of effective communication and good information technology. It is on account of merger of communication technology and information technology which enables the banks to offer core banking needs of the clients.

Core Banking Solutions are computer based banking applications (software) which works on a platform. The computer software handles the different functions of the bank like, recording of transactions, updating the balances in the accounts based on the type of transactions, calculate interests and application of interest, charges etc., The software is installed in the

branches and the computer systems are interconnected with a main computer server through communication lines (telephones, satellite, internet, fibre optical)

CBS is a back end system, and it processes daily banking transactions and updates the records accordingly. CBS helps the clients to operate their accounts from any CBS branch. CBS branch assist customers to handle their funds transfers in a quick turnaround time. It also assists the client to withdraw and deposit funds in other branches apart from the parent branch, where he maintains his account.

Data Warehousing: A Data Warehouse or Enterprise Data Warehouse (DWH/EDW) is a database used for reporting and data analysis. It is a central repository of data which is created by integrating data from one or more separate sources. DWH store current as well as historical data and are used for creating trending reports for use by senior management. The data stored in the warehouse are uploaded from the operation systems. The main source of data is cleaned, transformed, catalogued and made available for use by the managers for data mining, online analytical processing and decision support.

Computerization of Clearing of Cheques: Over the years Reserve Bank of India as a facilitator has been playing a vital role in the implementation of innovative systems, to enable banks not only to function effectively but also to offer better customer service. RBI is in charge of the clearing house and clearing operations. It has always taken lead to introduce new systems to speed up clearing process as well to reduce the turnaround time in clearance of funds. Computerization of clearing operations was the first major step initiated by RBI, over the years RBI has been upgrading the system with new changes. To overcome the increasing volume of cheques through the clearing mechanism, RBI has fully automated the clearing house operations. This is based on the Magnetic Ink Character Recognition technology (MICR); RBI upgraded the clearing functions with new set of MICR cheques. Under this new system, cheques should have MICR code consisting of 9 digits. Each cheque would have the unique 9 digit MICR code along with the cheque number.

MICR code consists of 9 digits as:

- First three digits indicates CITY {identical to the first three digit of the postal pin code of the CITY (For example: in case of Mumbai, it would be 400)}
- Next three digits represents the Bank and each bank has been given a three digit code called bank code
- Last three digits denote the branch code Under this MICR system the computer program would read and sort out the cheques based on the codes, thereby, in quick turnaround time, the system is able to handle volume.

Cheque Truncation System (CTS): Cheques are being used as a medium for exchange of funds, which play a key role in the funds management of customers and banks. The efficient cheque clearing system helps in settlement of receipts and payments. Cheque Truncation is a new system introduced in Indian Banking Scenario. It is a system of cheque clearance and settlement between banks based on electronic data and/or images without the need for exchange of physical cheques and negotiable instruments like demand drafts, pay orders, dividend warrants, etc.

Cheque truncation - Special features:

- Bank customers would get their cheques realized faster
- Quick realization helps in better cash management (receivables/payables)
- In the long run, it would reduce the administrative costs for bank
- Importantly this would assist banks' in reconciliation and also reduction in clearing frauds.

Risks - Some of the important risks associated with payment systems are:

- Credit Risk: Failure by a party to meet the financial obligations
- Liquidity Risk: A party in the system fails to pay on account of insufficient funds
- Operational Risk: A risk can arise on account of human error, system failure, frauds etc.
- Legal Risk: Non compliance of legal or regulatory framework can create a legal risk
- Systemic Risk: It can have a chain effect into the system due to the default of one of the parties

The following Acts and Regulations handle the payment and settlement in India:

- The Payment and Settlement Systems Act, 2007
- The Payment and Settlement Systems Regulation, 2008
- Board for Regulation and Supervision of Payment and Settlement Systems Regulations, 2008

Information Technology Act, 2000 & other Relevant Acts: Information Technology Act 2000 provides legal protection for transactions carried out by means of electronic communication. In view of the recognition given to electronic records, electronic signatures, and electronic documents, the banks are also required to follow the amendments of other Acts, such as,

- i. The Indian Penal Code 1860
- ii. The Indian Evidence Act 1872
- iii. The Indian Negotiable Instruments Act, 1881
- iv. The Banker's Books Evidence Act, 1891
- v. The Reserve Bank of India Act 1934



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1. Industrial finance corporation of India (IFCI)

It was established in 1st July 1948 the main object of IFCI is to make medium and long term credit to the industrial units.

Function

1. Granting loans and advances for the period of 25 years.
2. Subscribing to the shares and debentures floated by industrial concerns.
3. Granting loans in foreign currencies.
4. Guaranteeing for deferred payments in respect of import of capital goods.

2. State Financial corporation (SFC)

The first SFC was established in 1953 in Punjab, at present there are 18 SFC's. The main object of the establishment of SFC is to meet the requirements of medium and small scale industries in various states.

3. Industrial credit and investment corporation of India (ICICI)

It was established in 1955 the main aim of the ICICI is to develop the industries under the private sectors only. It is a private bank.

4. State Industrial Development cooperation (SIDC)

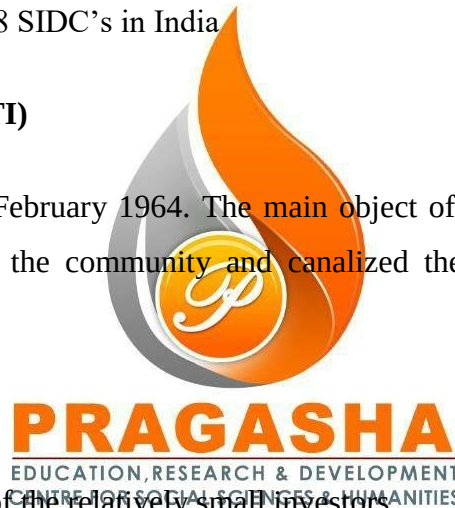
The main object for the establishment of SIDC is to achieve the rapid industrialization in the state at present there are 28 SIDC's in India

5. Unit trust of India (UTI)

It was established in 1st February 1964. The main object of the UTI is to encourage and mobilized the savings of the community and canalized them into productive corporate investment.

Function of UTI:

1. Mobilized the saving of the relatively small investors.
2. Channelized these small savings into productive investments.
3. Distribute the large scale economies among small income groups.



6. Industrial Development Bank of India (IDBI)

It was established in July 1964. It is the apex bank in the industrial credit, upto 1976 it the subsidiary bank to RBI but after 1976 it was formed as autonomous cooperation.

Functions of the IDBI:

1. It can establish the co-operation & Co-ordination among the industrial financial institutions.

2. It provide the direct finance to industrial units.
3. It saves the weaker industrial units through the development assistant fund.
4. It assists in the creation, expansion & modernization of industrial units under private sectors.
5. It also provides the export finance.

7. Export and Import Bank of India (EXIM bank)- 1982:

It was established in 1st March 1982. It is a non-bank financial intermediary (NBFI) confined its area of operations to foreign trade of India. It also performs other functions.

1. Export rediscounting
2. Re-finance supply credit
3. Bulk import finance
4. Foreign currency pre-shipment credit.
5. Product equipment finance programme.
6. Business advisory technical assistance (BATA)



8. National Bank Agriculture and Rural Development (NABARD)

It was established in July 1982 on the basis of the recommendations' of CRAFI CARD.

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1. It is the apex body in the agricultural credit
2. It taking over the functions of agriculture credit department of RBI and Agriculture re-finance development corporation (ARDC).
3. It provides all sources of refinance to the cooperatives, commercial banks and regional rural banks (RRB)

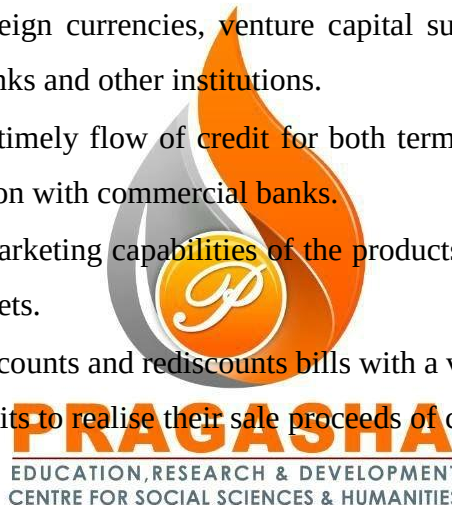
It also promoting the research in agriculture and rural development.

9. Small Industries Development Bank of India (SIDBI)

Small Industries Development Bank of India (SIDBI) was established in October 1989 and commenced its operation from April 1990 with its Head Office at Lucknow as a development

bank. It is the principal and exclusive financial institution for the promotion, financing and development of the Micro, Small and Medium Enterprise (MSME) sector and for co-ordination of the functions of the institutions engaged in similar activities. It is a central government undertaking. The prime aim of SIDBI is to support MSMEs by providing them the valuable factor of production finance. Many institutions and commercial banks supply finance, both long-term and short-term, to small entrepreneurs. SIDBI coordinates the work of all of them. The important functions of SIDBI are discussed as follows:

- (i) Initiates steps for technology adoption, technology exchange, transfer and up gradation and modernisation of existing units.
- (ii) SIDBI participates in the equity type of loans on soft terms, term loan, working capital both in rupee and foreign currencies, venture capital support, and different forms of resource support to banks and other institutions.
- (iii) SIDBI facilitates timely flow of credit for both term loans and working capital to MSMEs in collaboration with commercial banks.
- (iv) SIDBI enlarges marketing capabilities of the products of MSMEs in both domestic and international markets.
- (v) SIDBI directly discounts and rediscounts bills with a view to encourage bills culture and helping the SSI units to realise their sale proceeds of capital goods / equipments and components etc.
- (vi) SIDBI promotes employment oriented industries especially in semi-urban areas to create more employment opportunities so that rural-urban migration of people can be checked.



10. National Housing Bank (NHB)

National Housing Bank was set up in July, 1988 as the apex financing institution for the housing sector with the mandate to promote efficient, viable and sound Housing Finance Companies (HFCs). Its functions aim at to augment the flow of institutional credit for the housing sector and regulate HFCs. NHB mobilizes resources and channelizes them to various schemes of housing infrastructure development. It provides refinance for direct housing loans given by commercial banks and non-banking financial institutions. The NHB also provides

refinance to Housing Finance Institutions for direct lending for construction/purchase of new housing/dwelling units, public agencies for land development and shelter projects, primary cooperative housing societies, property developers. At present, it is a wholly owned subsidiary of Reserve Bank of India which contributed the entire paid-up capital. RBI has proposed to transfer its entire shareholding to Government of India to avoid conflict of ownership and regulatory role. For this transfer, the central bank will pay RBI, in cash, an amount equal to the face value of the subscribed capital issued by the RBI.

OTHER FINANCIAL INSTITUTIONS

11. Life Insurance corporation of India (LIC)

It was established in 1956 by nationalizing 245 private insurance companies. The primary object of nationalization was to protect the interest of the policy holders and avoid the misuse of funds secondly, the object of nationalization was to direct the investments of funds in government security (87.5%), leaving a small part for private sector (12.5%).

12. General insurance company (GIC)

It was formed as Government Company in 1972. Before nationalization a few big companies and about 100 small companies were in this business. At present GIC is provided 4 companies they are

- (i) National Insurance Company (NIC)
- (ii) New India Assurance company (NIAC)
- (iii) Oriental fire and general insurance company
- (iv) United India fire and general insurance company

The main feature of GIC is to sell insurance services against some forms of risk like loss of physical assets of various kinds i.e. The fire accident, and against personal sickness and accidents.

13. Securities and Exchange Board of India (SEBI)

It was setup in 1988. It got statutory reorganization in 1992. The main purpose of the SEBI is regulating business in stock markets & other securities market.

14. Asian Development Bank (ADB)

- It was established in 1966
- The main aim for the establishment of ADB is to promote the socio and economic progress of number countries in Asia & pacific.
- It is owned by governments of 37 countries form region and 16 countries from outside the region.
- Its head quarters is manila, Philippines
- Poverty reduction is now the main mission of DAB

15. International Monetary Fund (IMF)

It was established in March 1947 one of the outcomes of Breton wood conference was IMF. The main object of IMF is to administer a code of fair practice in the sphere of foreign exchange and to make loans to the economies experiencing temporary deficit in their balance of payments.

Quota:



It is the membership contribution fixed in terms of its national income and internal trade members are required to subscribe quota partly in gold (25%) party in domestic currency (75%).

Exchange rate:

Members of IMF had to declare the par value of national currency in terms of gold or American dollars.

Once the par value of different currencies is fixed it becomes easy to determine the rate of exchange between two countries.

16. Special Drawing Rights (SDRs)

SDR's was first introduced in 1969. It is the special currency issued by IMF. For two reasons IMF created SDR. They are

1. To overcome the shortage of gold in the world economy
2. To avoid the movement of gold across national boundaries.

SDRs are in Coupons:

It is used in the place of gold. Hence it is called paper gold.

17. World Bank:

It was established in 1947 one of the outcomes of Breton wood conference was establish of World Bank. The main aim of the establishment of World Bank is to help re-construction of the member countries damages due to the Second World War. The original name of World Bank is international bank for reconstruction and development (IBRD).

18. International development Association (IDA)

It was established in 1960 and it is affiliated to World Bank. The main aim for the establishment of IDA is to provide assistance to low developed countries (LDC) whose per – capita income in less than (dollar) \$ 520 (1975). It also grants the credit on cheap terms compared to World Bank loans.

DEMONETIZATION

Demonetization is the act of stripping a currency unit of its status as legal tender. The old unit of currency must be retired and replaced with a new currency unit.

On 8 November 2016, Prime Minister Narendra Modi announced the “demonetisation” of Rs. 500 and Rs. 1,000 notes with effect from the next day. Through the days after 8 November, the government has made a set of claims with regard to the objectives and outcomes of the demonetisation scheme.

The first claim is that demonetisation would plug terror financing. The second claim is that demonetisation would help unearth “black money.” The third claim is that the unearthed black money would expand the fiscal space of the government. When unaccounted cash is not returned to the banking system, the Reserve Bank of India (RBI) can use the savings to pay the government a dividend. The fourth claim is that demonetisation would help reduce interest rates in the banking system. The fifth claim is that demonetisation would help formalise India’s informal economy, reduce the extent of transactions in cash and help create a “less-cash economy.” A number of incentives have been offered to induce people to use digital transactions.

Demonetization as a cleaning exercise may produce several good things in the economy. The immeasurable benefits of having more transparency and reduced volume of black money activities can be expected as long-term benefits.

CURRENCY MANAGEMENT

One of the main functions of the **Reserve Bank of India (RBI)** is **maintaining and regulating currency notes**. The notes made of cotton and cotton rag is **designed, printed, and circulated** in the market. It makes sure that there is enough currency in the system. It includes both notes as well as coins. The bank also **regulates gold and foreign securities** when issuing and managing currencies. It maintains a balance between the **currencies available in the market against gold and foreign securities**.

The RBI manages currency and its related issues as per **Section 22 of RBI Act, 1934**. It ensures that the **integrity of the currency** is maintained. It **plans, designs, issues, and withdraws currency notes**. New notes are introduced in the market and soiled notes are withdrawn.

Years back, the **Paper Currency Act** was introduced in 1861 where the government was given the sole responsibility to manage currency. This Act ensures that currency is not introduced by banks, say presidential or private ones.

After the **RBI was formed in 1935**, it took over tasks related to currency management from the **Office of the Controller of Currency**. Today, **RBI has the sole right** in currency rights and management.

Role of Government in Currency Management

The Indian government has a role in issuing currency in the market. Till 1994, it issued only one-rupee notes and coins of all denominations in the market as per **Coinage Act 2011**. Now, it issues coins of all denominations only. The RBI is nevertheless **contemplating to introduce one-rupee note again**. It has said that it will introduce the notes in **pink-n-green color with an image of oil exploration rig, Sagar Samrat**.

The notes of **higher denominations are issued by the RBI**. However, it does so after consultations with the central government. As per rules under **Section 25 of RBI Act, 1934**, the banknotes of various denominations are recommended by the RBI. The central government approves the recommendation. It also **designs and mints the coins of multiple denominations**.

Both the RBI and the Indian government consult with the bank to design banknotes. The old notes which are unfit for circulation are slowly removed from the system. The **India Government Mints (IGM)** offers a range of services to mint currency notes and coins – such as **designing and engraving coins**.

Banking Awareness: Department of Currency Management

The RBI executes currency management tasks through the Department of Currency Management. There are ‘currency chests’ where bank notes are stored. These chests are kept in selected banks across the country. There are 4209 such chests in banks, such as the State Bank of India (SBI), six associate banks, private sector banks, and regional rural banks. There are also depot coins as well which store coins of various denominations. There are 3966 small coins depots which distribute small coins.

The RBI has 19 offices across various states in India that manages currency operations. However, there are few cities which directly get currencies from the mint. These are New Delhi, Hyderabad, Kolkata, and Mumbai.

Important tasks by the Department of Currency Management include:

- Designing banknotes
- Assessing demand for more notes and coins in the market
- Distributing of banknotes and withdrawing old ones (soiled/mutilated notes)
- Keeping the Integrity of bank notes
- Implementing Note Refund Rules

Legality of the RBI Notes

The RBI keeps the face value of all the notes issued by it. In fact notes issued earlier do not lose its legal status. Notes can be exchanged at any branch. However, notes of higher denominations, such as those of Rs. 1,000, Rs. 5000, and Rs. 10,000 are not exchanged in any commercial branch. Only RBI has the authority to exchange the same.

The apex bank and the government co-ordinate to...

- Check the security issues of the currency notes.
- Decide on the denomination and number of banknotes to be issued.

The RBI also places indent each year to mint and issue the currency notes after assessing the quantity of banknotes. The Indian government authorizes the mints to print the currency notes based on the indent.

Small Coins and Rupee Coins

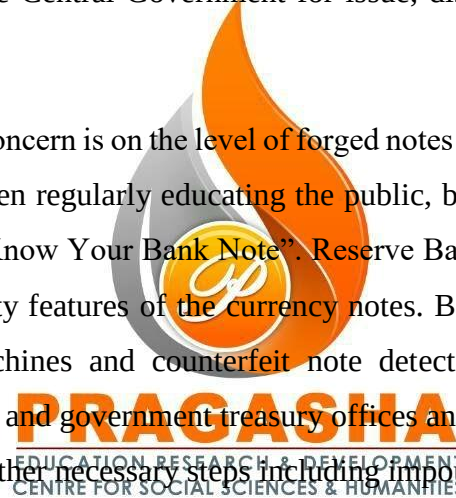
The Indian currency is known as Indian Rupee (INR). The symbol of Indian Rupee is taken from the Devanagari letter and Latin Capital letter 'R'. Additionally, there are two horizontal lines on the top. Today, only 50 paise coins – known as small coins – are accepted. The other

coins, such as one Rupee, 5 Rupee, and 10 Rupee coins are available in the market. Coins below 50 paise, such as 25 paise, 20 paise, or 10 paise coins have been withdrawn since 2011.

Currency Printing and Coin Minting

The Government of India on the advice of the Reserve Bank of India decides on the various denominations for printing the notes. The Reserve Bank coordinates with the Government in designing the bank notes. Printing of currency notes are handled by the Security Printing and Minting Corporation of India Limited (SPMCIL) and The Bharatiya Reserve Bank Note Mudran Pvt Ltd (BRBNMPL) in their different printing presses setup at Nashik, Devas, Mysore. SPMCIL has mints for coin production at Mumbai, Noida, Hyderabad. The Reserve Bank acts as agent for the Central Government for issue, distribution, withdrawing of the coins.

Reserve Bank of India's concern is on the level of forged notes penetrated into the circulation. The Reserve Bank has been regularly educating the public, banks and others through press releases and display of "Know Your Bank Note". Reserve Bank from time to time circulate information on the security features of the currency notes. Banks are advised to install the required ultra violet machines and counterfeit note detecting machines. Reserve Bank provides training to banks and government treasury offices and issues detailed guidelines on how to detect and take further necessary steps including impounding of such notes.



VARIOUS BANKING RATES IN INDIA

Monetary policy of any country is the process through which the central bank of that country normally controls the supply of money in its economic system by its control over interest rates in order to maintain price stability and perform to achieve high economic growth. In India, such apex bank is the **Reserve Bank of India (RBI)**. It is responsible to maintain the price stability in India. Besides, there are many other objectives of the monetary policy of India, which are governed and performed by the RBI. Out of them, there are various types of rates which are variable as per the economic scenario of the country and are decided by the RBI time to time. Generally, these rates are decided every financial year and if needed, those

can be revised according to the changing economic conditions. Some important rates in India are:

Repo rate: Repo rate is the rate at which banks borrow money from the RBI to meet their deficiencies. Banks do pledge their holdings of government bonds as collateral and in against of it, banks borrow from the Reserve Bank of India. When the RBI decides to reduce the borrowing by the banks it increases the repo rate. This is done when the economy is overheated and needs to be cooled. Similarly, when the RBI wants to make it cheaper for banks to borrow the money, it reduces the repo rate. This is done when the economy is not doing too well. In other words, it can be said that reduction in Repo rate helps the commercial banks to get money at a cheaper rate while increase in Repo rate discourages the commercial banks to get money as the rate increases and becomes expensive.

Reverse Repo Rate: On the contrary of Repo Rate, the rate at which RBI borrows money from the banks is called as the reverse repo rate. Reverse Repo rate is the rate at which RBI borrows money from the commercial banks. The RBI uses this tool when there are more than enough money floating in the banking system. This rate encourages the banks to give money back to RBI and earn some interest on it. This happens when banks don't have enough consumers/ companies to lend the money to and money is lying idle with the banks. When the reverse repo rate is increased, RBI borrows money from the banks and offers them at a lucrative rate of interest. Hence, banks prefer to keep their money with the RBI which is absolutely risk free in comparison to lending anywhere else.

Bank Rate: Bank rate is the rate of interest charged by the RBI against the funds lent to the banking system. This banking system incorporates commercial and co-operative banks, Industrial Development Bank of India, etc. Hike in Bank Rate increases the cost of borrowing by commercial banks which results in the reduction in credit volume to the banks and hence declines the supply of money. When RBI increases the bank rate, it means it's a symbol of tightening the monetary policy. A change from low to high Bank rate means the economy needs cooling down. In other words, the RBI would like to reduce inflation. A change from high to low Bank rate means the economy needs a boost. In other words, the RBI would like to increase inflation.

Call Rate: Call rate is also known as the interest rate which is paid by the banks for lending and borrowing for daily fund requirement. Since banks need funds on a daily basis, they lend to and borrow from other banks to fulfill their daily requirements which is also known as short-term requirements on a regular basis.

Cash Reserve Ratio (CRR): The part of deposits in cash that a bank has to keep/maintain with the RBI mandatorily is known as Cash Reserve Ratio. It is usually considered that such part of bank deposits is totally risk-free. It supports the RBI in controlling the liquidity in the banking system. Furthermore, it helps to curve the inflation as well. It is actually a certain percentage of bank deposits which banks are bound to keep with RBI in the form of reserves. It is said that the higher the CRR with the RBI is, the lower the liquidity in the system would be. The Reserve Bank of India has the power to exercise and vary the CRR rate

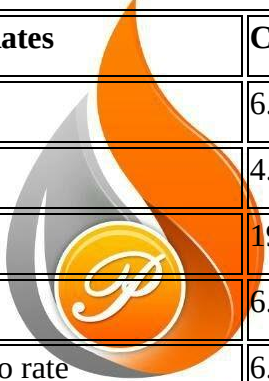
Statutory Liquidity Ratio (SLR): In addition to the CRR, banks are also bound to invest a portion of their deposits in government securities as a part of their statutory liquidity ratio (SLR) requirements. The purpose behind the SLR is to restrict the bank's leverage so that pumping more money into the economy can be ensured. Every banking/ financial organisation has to maintain some certain quantity of liquid assets with themselves at any point of time during their total time and demand liabilities. These deposits can be kept in the form of Government securities, Gold, approved securities like bonds etc. The ratio of the liquid assets to time and demand assets is termed as the Statutory liquidity ratio. When banks don't have excess collateral which is basically the government bonds to borrow from the Reserve Bank of India to maintain their deposits as collateral in government securities is called the statutory liquidity ratio. A huge reduction from 38.5% to 25% in SLR took place after the Narshimam Committee recommendation came out.

Marginal Standing Facility: Marginal Standing Facility (MSF) rate is the rate at which the scheduled banks borrow funds overnight from RBI against the Government securities. Marginal Standing Facility is well known as a very short term borrowing scheme to help the scheduled commercial banks.

If the banks have excess government bonds over and above the SLR, they can borrow from the Reserve Bank of India under the repo window. But in case any bank that doesn't have excess SLR securities, they can still draw down on their holding of SLR securities and borrow from the Reserve Bank of India at the marginal standing facility rate.

Inflation: In India, inflation is measured based upon the Indian consumer price index. The index is basically a measure of the average price that consumers spend on goods and services around the year. Inflation based consumer price index (CPI) is the main inflation indicator practiced in most of the countries.

RECAP OF VARIOUS RATES IN BANKING SYSTEM OF INDIA (AS ON Nov, 2018)



Different Rates	Current rate
Bank rate	6.75%
CRR	4.00%
SLR	19.5%
Repo rate	6.50%
Reverse repo rate	6.25%
Marginal Standing facility rate	6.75%

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BANCASSURANCE

Bancassurance refers to sell the insurance policies using the branches of banks to the customers of the bank. Under Bancassurance, insurance plans are provided to people through wide network of banking services along with full range of banking and investment products and services.

Guidelines of RBI for Bancassurance

The Reserve Bank of India (RBI) has issued final guidelines for commercial banks to enter into the insurance industry along with the announcement of the Monetary and Credit Policy 2000-2001

Following are the guidelines issued by the Reserve Bank of India

- A Commercial Bank can undertake insurance business as an agent of insurers on fee basis.
- Commercial banks would be allowed to enter into a joint venture company for undertaking insurance business with risk participation which fulfills the eligibility criteria. This eligibility criteria will be as under:
 1. The net worth of the bank should not be less than Rs 500 crore
 2. Reasonable level of Net Present Value
 3. Bank must have the net profit for the continuous three years.
- Commercial banks may be permitted to participate in the equity on the insurance joint venture with the approval of IRDA.
- A subsidiary of a bank would not be permitted to participate in insurance business on risk participation basis.
- It is essential to obtain prior permission of the Reserve Bank of India for bank to enter into insurance business.



Bancassurance Alliances in India

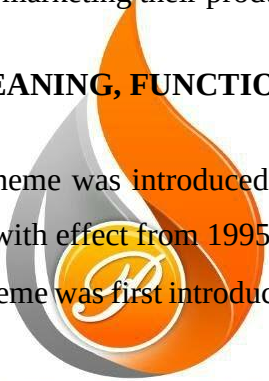
- Life Insurance Corporation of India has alliance with Corporation Bank, Indian Overseas Bank, Centurion Bank, Cooperative Bank, Vijaya Bank
- Birla Sun Life Insurance Co. Ltd. has alliance with Bank of Rajasthan, Andhra Bank, Bank of Muscat, Development Credit Bank
- HDFC Standard Life Insurance Co. Ltd. has alliance with Union Bank of India.
- ICICI Prudential Life Insurance Co. Ltd has alliance with Lord Krishna Bank, ICICI Bank, Bank of India, and Allahabad Bank.
- National Insurance Co. Ltd. has alliance with City Union Bank.
- Dabur CGU Life Insurance Company Pvt. Ltd. has alliance with Canara Bank, Lakshmi, American Express Bank.
- SBI Life Insurance Company Ltd. has alliance with State Bank of India.
- Bajaj Allianz General Insurance Company Ltd. has alliance with Karur Vysya Bank and Lord Krishna Bank.

- United India Insurance Co. Ltd. has alliance with South Indian Bank.

Benefits of Bancassurance

- The cost is much lesser for the insurers using the banking channel as compared to traditional channels of insurance in India.
- The Banking organisation is also benefited through Bancassurance. It helps to increase return on assets, through fee income.
- Banks are the significant distribution channel for the sale of insurance policies due to face to face relation with customers and wider network of distribution and processing capabilities.
- Banks have vast experience in marketing their products to existing clients and outsiders.

BANKING OMBUDSMAN: MEANING, FUNCTIONS AND WORKING

- 
- The Banking Ombudsman Scheme was introduced under Section 35 A of the Banking Regulation Act, 1949 by RBI with effect from 1995.
 - The Banking Ombudsman Scheme was first introduced in India in 1995 and it was revised in 2002.
 - Current Banking Ombudsman Scheme introduced in 2006.
 - From 2002 until 2006, around 36,000 complaints have been dealt by the Banking Ombudsmen.
 - Banking Ombudsman is appointed by Reserve Bank of India.
 - Banking Ombudsman is a senior official appointed by RBI. He handle and redress customer complaints against deficiency in certain banking services.
 - The offices of Banking Ombudsman is mostly situated at State Capitals.
 - Around 15 Banking Ombudsmen have been appointed.
 - All Scheduled Commercial Banks, Regional Rural Banks and Scheduled Primary Co-operative Banks are covered under the Banking Ombudsman Scheme.

Grounds of Complaints

One can file a complaint on the following grounds of complaints:

1. Any excessive delay or non - payment of collection of cheques, drafts, bills etc.
2. Without any sufficient cause non acceptance of small denomination notes.
3. Charging any commission for acceptance of small denominations notes
4. Any delay in payment of inward remittances or non payment of inward remittances.
5. If any banking organization refuses to accept taxes or any delaying in accepting taxes (as required by RBI or Government of India).
6. Any delay in issuing government securities
7. Refusal to issue or redemption of government securities.
8. Without any sufficient reason, forced close the deposit accounts by bankers.
9. If any banker refuse to close the accounts
10. If any banker deliberately delaying in closing the accounts.
11. Non compliance of the provisions of Banking Codes and Standard Board of India.
12. If any banker commits non - observance of Reserve Bank of India's guidelines or instructions or any violation of the directives issued by the Reserve Bank in relation to banking or other services.
13. Without any sufficient cause, non-acceptance of coins tendered or charging of commission in respect thereof.
14. Delay or Failure in issue of drafts, pay orders or banker's cheques.
15. Performance of work is not as per prescribed working hours.
16. Delay or failure in providing any bank facility.
17. Complaints file by Non - resident Indians having accounts in India in relation to their remittance from abroad, deposits and other bank related matters.
18. Without any reason, refusal to open deposit accounts.
19. Without adequate prior notice to the customer, charges levied by the banker.
20. Any violation of guidelines or instructions of RBI on ATM/Debit Card/Credit Card operations.
21. Non - disbursement or delay in disbursement of pension.

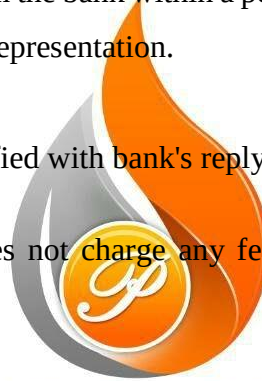
Other Grounds

A customer can also file a complaint on the following grounds of deficiency in service with respect to loans and advances:

1. The Banking Ombudsman may also deal with such other matter as may be specified by the Reserve Bank from time to time.
2. Without any valid reason non - acceptance of application of loans.
3. Any violation of the provisions of the fair practices code for lenders as adopted by the bank or Code of Bank's Commitment to Customers, as the case may be.
4. Any type of violation of the instruction, guidelines, recommendations of the RBI
5. If any non - observance of Reserve Bank Directives on interest rates;
6. Any delays in sanction of loan applications

Reasons, when you can File a Complaint

1. If the reply is not received from the bank within a period of one month after the concerned bank has received complaint representation.
2. If bank rejects the complaint.
3. If the complainant is not satisfied with bank's reply.
 - Banking Ombudsman does not charge any fee for filing and resolving customer's complaints.
 - If any loss suffered by the complainant then complainant is limited to the **amount arising directly out of the act or omission of the bank or Rs. 20 Lakhs whichever is lower.**



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Recent Amendments

- Reserve Bank of India has widen the scope of its Banking Ombudsman scheme, 2006, to include deficiencies arising out of sale of Insurance/ mutual fund/ other third-party investment products by Banks. For example, if IDBI bank is selling mutual funds of Reliance Mutual Funds. If Reliance Mutual funds did not provide the promised services, then IDBI bank will be made liable for the damages.
- Under the amended scheme a customer would also be able to file a complaint against the Bank for its non-adherence to RBI instruction with regards to Mobile Banking/Electronic Banking services in India.

- The procedure for complaints settled by agreement under the scheme has also been revised. Appeal has now been award for the complaints closed under 13(C) of the existing scheme related to rejection which was not available earlier.

LIST OF COMMITTEES RELATED TO BANKING

- A C Shah Committee: NBFC
- A Ghosh Committee: Final Accounts
- A Ghosh Committee: Modalities Of Implementation Of New 20 Point Programme
- A Ghosh Committee: Frauds & Malpractices In Banks
- AbidHussain Committee: Development Of Capital Markets
- Adhyarjuna Committee: Changes In NI Act And Stamp Act
- AK Bhuchar Committee: Coordination Between Term Lending Institutions And Commercial Banks.
- B Eradi Committee: Insolvency And Wind Up Laws
- B Sivaraman Committee: Institutional Credit For Agricultural & Rural Development
- B Venkatappaiah Committee: All India Rural Credit Review
- BD Shah Committee: Stock Lending Scheme
- BD Thakar Committee: Job Criteria In Bank Loans (Approach)
- Bhagwati Committee: Unemployment
- Bhagwati Committee: Public Welfare
- Bhave Committee: Share Transfer Reforms
- Bhide Committee: Coordination Between Commercial Banks And SFC's
- Bhootlingam Committee: Wage, Income & Prices.
- C Rao Committee: Agricultural Policy
- CE Kamath Committee: Multi Agency Approach In Agricultural Finance
- Chatalier Committee: Finance To Small Scale Industry
- Chesi Committee: Direct Taxes
- Cook committee (On Behalf Of BIS – Under Basel Committee):Capital Adequacy Of Banks.



- D R Mehta Committee: Review Progress And Recommend Improvement Measures Of IRDP
- Damle Committee: MICR
- Dandekar Committee: Regional Imbalances
- Dantwala Committee: Estimation Of Employments
- Dave Committee: Mutual Funds (Functioning)
- Dharia Committee: Public Distribution System
- DR Gadgil Committee: Agricultural Finance
- Dutta Committee: Industrial Licensing.
- G Lakshmai Narayan Committee: Extension Of Credit Limits On Basis Of Consortium
- G Sundaram Committee: Export Credit
- Gadgil Committee (1969): Lead Banking System
- Godwala Committee: Rural Finance
- Goiporia Committee: Customer Service In Banks
- GS Dahotre Committee: Credit Requirements Of Leasing Industry
- GS Patel Committee: Carry Forward System On Stock Exchanges.
- Hathi Committee: Soiled Banknotes
- Hazari Committee (1967): Industrial Policy
- IT Vaz Committee: Working Capital Finance In Banks.
- J Reddy Committee: Reforms In Insurance Sector
- James Raj Committee: Functioning Of Public Sector Banks
- Jankiraman Committee: Securities Transactions Of Banks & Financial Institutions.
- JV Shetty Committee: Consortium Advances.
- K Madhav Das Committee: Urban Cooperative Banks
- Kalyansundaram Committee: Introduction Of Factoring Services In India
- Kamath Committee: Education Loan Scheme
- Karve Committee: Small Scale Industry
- KB Chore Committee: To Review The Symbol Of Cash Credit Q
- Khanna Committee: Non Performing Assets



- Khusrau Committee: Agricultural Credit
- KS Krishnaswamy Committee: Role Of Banks In Priority Sector And 20 Point Economic Programme.
- L K Jha Committee: Indirect Taxes
- LC Gupta Committee: Financial Derivatives.
- Mahadevan Committee: Single Window System
- Mahalanobis Committee: Income Distribution
- Marathe Committee: Licensing Of New Banks
- ML Dantwala Committee: Regional Rural Banks
- Mrs. KS Shere Committee: Electronic Fund Transfer.
- Nadkarni Committee: Improved Procedures For Transactions In PSU Bonds And Units
- Nariman Committee: Branch Expansion Programme
- Narsimham Committee: Financial System.
- OmkarGoswami Committee: Industrial Sickness And Corporate Restructuring.
- P R Nayak Committee: Institutional Credit To SSI Sector
- P Selvam Committee: Non Performing Assets Of Banks
- PC Luther Committee: Productivity, Operational Efficiency & Profitability Of Banks
- PD Ojha Committee: Service Area Approach
- Penderkar Committee: Review The System Of Inspection Of Commercial, RRB And Urban Cooperative Banks
- Pillai Committee: Pay Scales Of Bank Officers
- PL Tandon Committee: Export Strategy
- PR Khanna Committee: Develop Appropriate Supervisory Framework For NBFC
- Purshottam Das Committee: Agricultural Finance And Cooperative Societies.
- R Jilani Banks: Inspection System Of Banks
- R S Saria Committee: Agricultural Finance And Cooperative Societies
- Raghavan Committee: Competition Law
- Raja Chelliah Committee: Tax Reforms
- Rajamannar Committee: Centre – State Fiscal Relationships



- Rajamannar Committee: Changes In Banking Laws , Bouncing Of Cheques Etc
- Rakesh Mohan Committee: Petro Chemical Sector
- Ram Niwas Mirdha Committee (JPC): Securities Scam
- Rangrajan Committee: Computerization Of Banking Industry
- Rangrajan Committee: Public Sector Disinvestment
- Rashid Jilani Committee: Cash Credit System
- Ray Committee: Industrial Sickness
- RG Saraiya Committee (1972): Banking Commission
- RH Khan Committee: Harmonization Of Banks And Ssis
- RK Hajare Committee: Differential Interest Rates Scheme
- RK Talwar Committee: Customer Service
- RK Talwar Committee: Enactment Having A Bearing On Agro Landings By Commercial Banks
- RN Malhotra Committee: Reforms In Insurance Sector
- RN Mirdha Committee: Cooperative Societies
- RV Gupta Committee: Agricultural Credit Delivery.
- S Padmanabhan Committee: Onsite Supervision Function Of Banks
- S Padmanabhan Committee: Inspection Of Banks (By RBI)
- Samal Committee: Rural Credit
- SC Choksi Committee: Direct Tax Law
- Shankar Lal Gauri Committee: Agricultural Marketing
- SK Kalia Committee: Role Of NGO And SHG In Credit
- SL Kapoor Committee: Institutional Credit To SSI
- Sodhani Committee: Foreign Exchange Markets In NRI Investment In India
- SS Kohli Committee: Rehabilitation Of Sick Industrial Units
- SS Kohli Committee: Rationalization Of Staff Strength In Banks
- SS Kohli Committee: Willful Defaulters
- SS Nadkarni Committee: Trading In Public Sector Banks
- SS Tarapore Committee: Capital Account Convertibility
- Sukhmoy Chakravarty Committee: To Review The Working Of Monetary System.



- Tambe Committee: Term Loans To SSI
- Tandon Committee: Follow Up Of Bank Credit
- Tandon Committee: Industrial Sickness
- Thakkar Committee: Credit Schemes To Self Employed
- Thingalaya Committee: Restructuring Of RRB
- Tiwari Committee: Rehabilitation Of Sick Industrial Undertakings.
- UK Sharma Committee: Lead Bank Scheme (Review)
- UshaThorat Panel: Financial Inclusion.
- Vaghul Committee: Mutual Fund Scheme
- Varshney Committee: Revised Methods For Loans (>2 Lakhs)
- Venketaiya Committee: Review Of Rural Financing System
- Vipin Malik Committee: Consolidated Accounting By Banks
- VT Dehejia Committee: To Study Credit Needs Of Industry And Trade Likely To Be Inflated
- Vyas Committee: Rural Credit.
- Wanchoo Committee: Direct Taxes
- WS Saraf Committee: Technology Issues In Banking Industry.
- Y H Malegam Committee: Disclosure Norms For Public Issues
- YV Reddy Committee: Reforms In Small Savings



Unit – 10: International Business

- ✓ Theoretical Foundations of International Business, Balance of Payments
- ✓ International Liquidity, International Economic Institutions - IMF, World Bank, IFSC, IDA, ADB
- ✓ World Trade Organisation - Its Functions and Policies
- ✓ Structure of Indian Foreign Trade: Composition and Direction, EXIM Bank, EXIM Policy of India, Regulations and Promotion of Foreign Trade
- ✓ Foreign Direct Investment and Multinational Corporation - MNCs Culture, MNCs and LDCs, Joint Ventures
- ✓ Regional Economic Integration: SAARC, ASEAN, EC, NAFTA
- ✓ India and WTO, Intellectual Property Rights
- ✓ Foreign Exchange - Exchange Rate, Mechanism, Risk Management, Transfer of International Payments, Convertibility of Rupee, Current and Capital Accounts, Issues and Perceptions, Derivatives And Futures
- ✓ Foreign Investment Institutions; Instruments: GDRs, ADRs, FIIs – their Role in Indian Capital Market



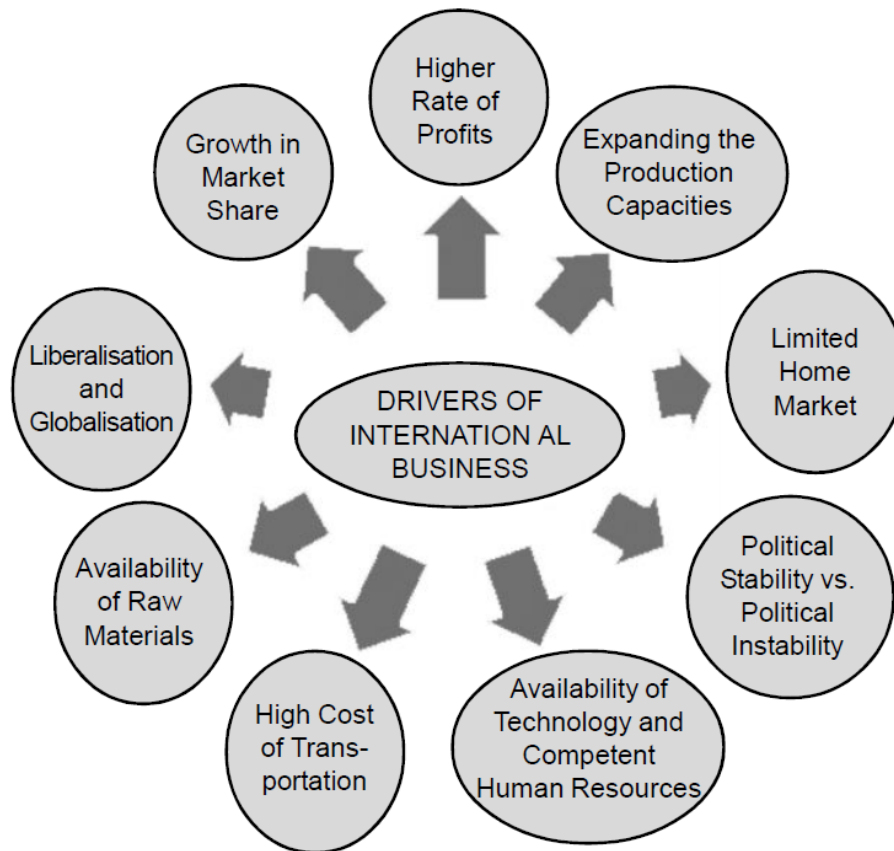
INTERNATIONAL BUSINESS

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International Business is the process of focusing on the resources of the globe and objectives of the organisations on global business opportunities and threats. International business is defined as global trade of goods/services or investment.

DRIVERS OF INTERNATIONAL BUSINESS



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BENEFITS OF INTERNATIONAL BUSINESS
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High Living Standards	Increased Socio-Economic Welfare	Wider Market	Reduced Effects of Business Cycles
Reduced Risks	Large-scale Economies	Potential Untapped Market	Provides the Opportunity to Domestic Business
Division of Labour and Specialisation	Economic Growth of the World at large	Optimum and Proper Utilisation of World Resources	Cultural Transformation

SCOPE OF INTERNATIONAL BUSINESS

The scope of international business is much broader involving international marketing, international investments, management of foreign exchange, procuring international finance from International Monetary Fund (IMF), World Bank, International Finance Corporation (IFC), International Development Association (IDA) etc., management of international human resources, management of cultural diversity, management of international production and logistics, international strategic management and the like.

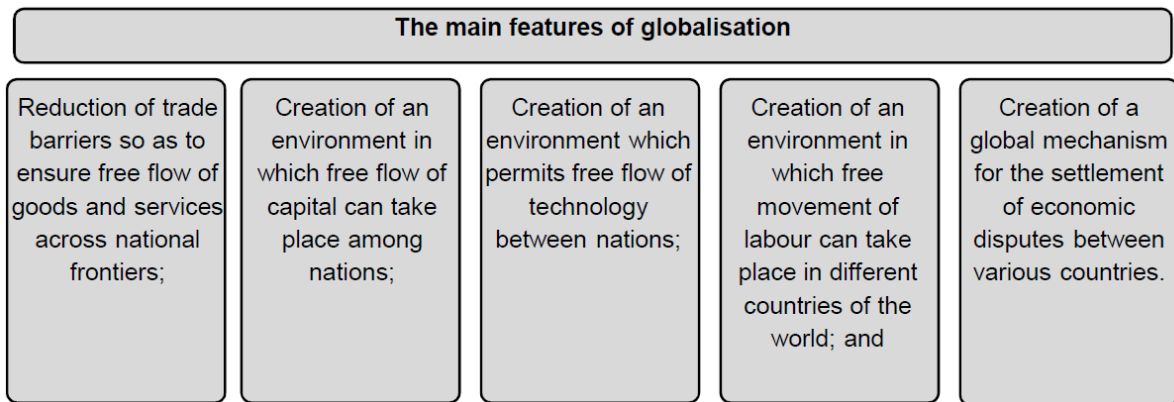
Meaning of Globalisation

Globalisation refers to the increasing integration of economies around the world, particularly through the movement of goods, services, and capital across borders. The term sometimes also refers to the movement of people (labour) and knowledge (technology) across international borders.

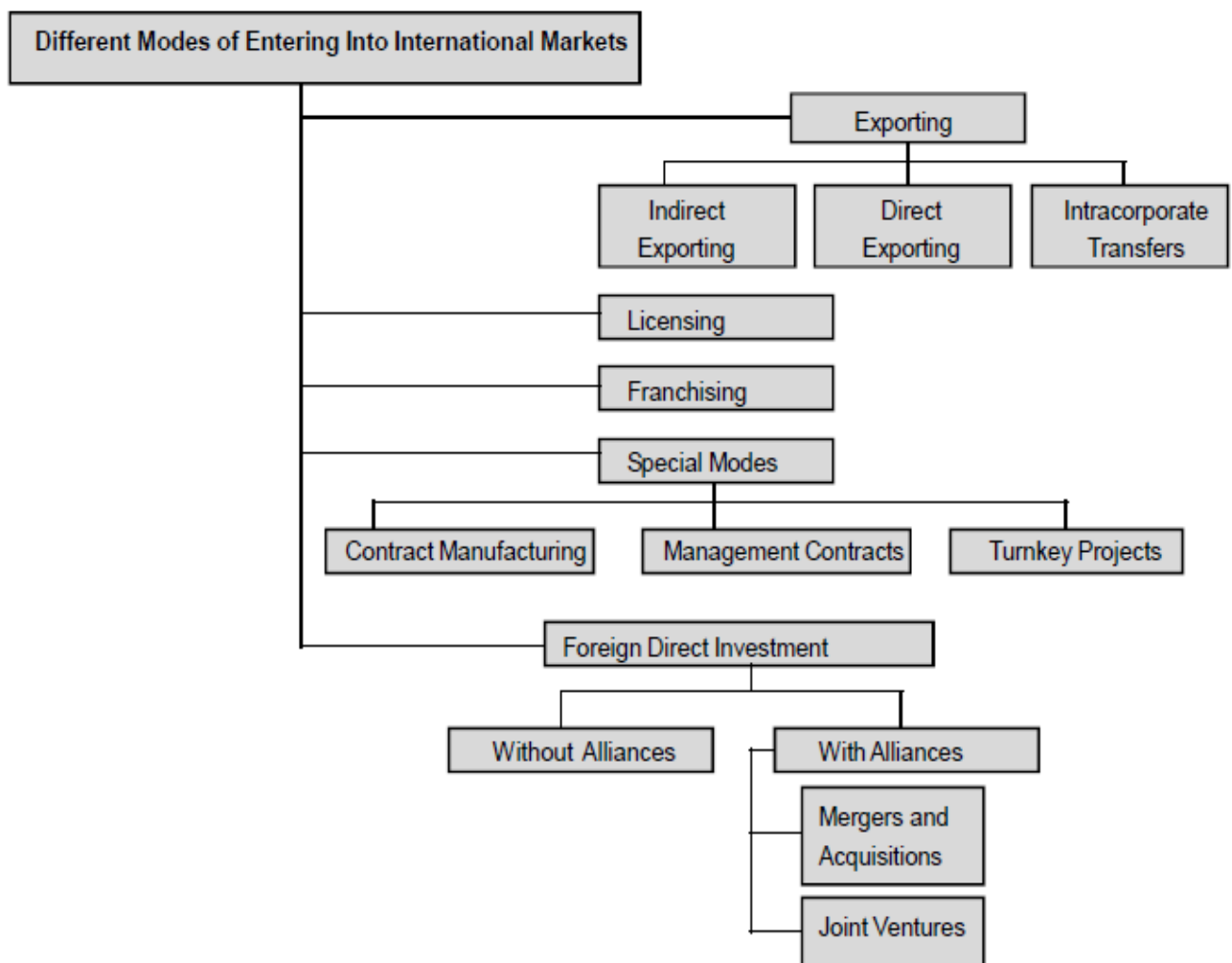
The term "globalisation" began to be used more commonly in the 1980s, reflecting technological advances that made it easier and quicker to complete international transactions – both trade and financial flows. It refers to an extension of the same market forces that have operated for centuries at all levels of human economic activity – village markets, urban industries, or financial centres beyond national borders.



According to International Monetary Fund (IMF), globalisation means “the growing economic interdependence of countries world wide through increasing volume and variety of cross-border transactions in goods and services and of international capital flows and also through the more rapid and widespread diffusion of technology”.



MODES OF ENTRY AND OPERATION IN INTERNATIONAL BUSINESS



EXPORTING

Exporting is the easiest and most widely used mode of entering in international markets. Exporters can be classified in various ways as given below.

1. *Small or Large exporters:* Depending upon the size of the business, exporters are classified as small or large exporters. Current foreign trade policy in India provides incentives and facilities to promote both small exporters and large exporters who are status holders due to their performance in earning foreign exchange.
2. *Single or Multi-product exporters:* Depending upon the product lines exported, they are classified as single product or multi product exporters.
3. Depending upon the legal status, exporters are classified as proprietary companies, partnership companies, private limited companies and public limited companies.
4. Depending upon the destination of exports, they are exporters as single destination exporters or multi destination exporters. Nowadays, the majority of companies adopt the philosophy of multi product, multi locational, multi strategic and multi-dimensional operations.
5. Depending upon the frequency of exports, exporters are classified as occasional exporters and dynamic exporters.



Exporting includes indirect exporting, direct exporting and intra-corporate transfers.

(1) Indirect Exporting

Indirect exporting is exporting the products either in their original form or in the modified form to a foreign country through another domestic company. It is the market entry technique which offers lowest risk & least market control. The firm is not engaged in international marketing and no special activity is carried on within the firm. The sale is handled just like domestic sales. **(2) Direct Exporting**

Direct exporting is selling the products to a country directly through its distribution arrangement or through a host country's company.

(3) Intra-corporate Transfers

Intra-corporate transfers means selling of product; by a company to its affiliated company in host country (another country).

Some of the factors to be considered by a company while exporting are as follows:

- Government policies like export policies, import policies, export financing, foreign exchange.
- Marketing factors like image, distribution networks, responsiveness to the customer, customer awareness and customer preferences
- Location consideration: These factors include physical distribution costs, warehousing costs, transportation costs, inventory carrying costs etc.

LICENSING

Licensing is the method of foreign operation whereby a firm in one country agrees to permit a company in another country to use the manufacturing, processing, trademark, know-how or some other skill provided by the licensor. Coca Cola is an excellent example of licensing. In Zimbabwe, United Bottlers have the license to make Coke. In return the licensee produces the licensor's products, market these products in his assigned territory and pay the licensor royalties related to the sales volume of the products. International licensing is an agreement

between the licensor and the licensee over a period of time for the use of brand name, marketing knowhow, copyright, work method, and trade mark by paying a licence fee. For example, British American tobacco company (BATS) has given licenses in many countries for the manufacture of their brand of cigarettes "555". In India, ITC is the licensed producer of "555". Pepsi cola granted license to Heineken of the Netherlands giving them the exclusive right to produce and sell Pepsi cola in the Netherlands. The licensor has minimum involvement in day to day functions. Therefore, the returns are also comparatively low. The

domestic company can choose any international location and enjoy the advantages without incurring any obligations and responsibilities of ownership, managerial, investment etc.

Licensing gives the following advantages:

- Good way to start in foreign operations and open the door to low risk manufacturing relationships
- It brings new technology and know-how in the licensees' country.
- Linkage of parent and receiving partner interests means both get most out of marketing effort
- Capital not tied up in foreign operation and Options to buy into partner exist or provision to take royalties in stock.

Some of the disadvantages of licensing are as follows:

- Limited form of participation - to length of agreement, specific product, process or trademark;
- Potential returns from marketing and manufacturing may be lost;
- Partner develops know-how and so licence is short;
- Licensees become competitors as once know-how is transferred, there is a risk that the foreign firm may act on its own.
- Requires considerable fact finding, planning, investigation and interpretation.

FRANCHISING

Franchising refers to the methods of practicing and using another person's business philosophy. The franchisor grants the independent operator the right to distribute its products, techniques, and trademarks for a percentage of gross monthly sales and a royalty fee. Various tangibles and intangibles such as national or international advertising, training, and other support services are commonly made available by the franchisor. Agreements may typically last from five to thirty years. A business for which franchising is said to work best have the following characteristics:

- Businesses with a good track record of profitability.
- Businesses built around a unique or unusual concept.
- Businesses with broad geographic appeal.
- Businesses which are relatively easy to operate.
- Businesses which are relatively inexpensive to operate.
- Businesses which are easily duplicated.

Franchisor: Selects franchisee and provides franchisor the services of operating systems, receives the fixed amount trade marks, product reputations and royalty from the & support systems like franchisee for providing the advertising, employee training, expertise and brand quality assurance programmes reputations to franchisee etc.

Franchisee: An independent organization, agrees to follow franchisor's requirement like appearance, operating procedures, financial reporting, customer service under a franchising agreement. Some Pays a fixed amount and flexibility allowed under the royalty based on the sales to agreement the franchisor



Advantages For franchisors

– **Expansion:** Franchising is one of the only means available to access venture investment capital without the need to give up control of the operation of the chain in the process. After the brand and formula are carefully designed and properly executed, franchisors are able to sell franchises and expand rapidly across countries and continents using the capital and resources of their franchisees, and can earn profits commensurate with their contribution to those societies while greatly reducing the risk and expense that would be inherent in conventional chain operations.

– **Legal considerations:** The franchisor is relieved of many of the mundane duties necessary to start a new outlet, such as obtaining the necessary licenses and permits. In some jurisdictions, certain permits (especially alcohol licenses) are more easily obtained by locally based, owner-operator type applicants while companies based outside the jurisdiction (and especially if they originate in another country) find it difficult if not impossible to get such

licences issued to them directly. For this reason, hotel and restaurant chains that sell alcohol often have no viable option but to franchise if they wish to expand to another state or province.

– **Operational considerations:** Franchisees are said to have a greater incentive than direct employees to operate their businesses successfully because they have a direct stake in the start up of the branded business and the tangible assets that wear the brand name. The need of franchisors to closely scrutinize the day to day operations of franchisees (compared to directly-owned outlets) is greatly reduced.

Advantages for franchisees

– **Employment:** As practiced in retailing, franchising offers franchisees the advantage of starting up a new business quickly based on a proven trademark and formula of doing business, as opposed to having to build a new business and brand from scratch (often in the face of aggressive competition from franchise operators).

– **Expansion:** With the help of the expertise provided by the franchisors, the franchisees may be able to take their franchised businesses to a level which they wouldn't have been able to without the expert guidance of their franchisors.

– **Training:** Franchisors often offer franchisees significant training, which is not available for free to individuals starting their own business. Although training is not free for franchisees, it is sometimes supported through the traditional franchise fee that the franchisor collects and tailored to the business that is being started. When training fees and travel expenses, etc. are required beyond the initial franchise fee, these fees are deductible as part of the start-up expenses of the business.

Disadvantages for franchisors

– **Control:** Successful franchising necessitates a much more careful vetting process when evaluating the limited number of potential franchisees than would be required in the hiring of direct employees who may have experience in the concept sector. An incompetent manager of a directly-owned outlet can easily be replaced, while, regardless of the local laws and



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agreements in place, removing an incompetent franchisee who owns the tangible assets of the business is much more difficult. Incompetent franchisees can easily damage the public's goodwill towards the franchisor's brand by providing inferior goods and services. If a franchisee is cited for legal violations, (s)he will probably face the legal consequences alone but the franchisor's reputation could still be damaged.

– **Limited pool of viable franchisees:** In any city or region there may be only a limited pool of prospects who have both the financial resources and the desire to purchase and start up a franchised business, as compared to the pool of individuals who can be hired and trained to competently manage directly owned businesses, as paid employees. However, in periods of recession where traditional good jobs are in short supply, this disadvantage disappears because those who can't find good jobs are willing to invest money in a franchise as a means of self-employment.

Disadvantages for franchisees

– **No guarantee:** usually, there is a guarantee of financial success for the franchisee made by the franchisor in the written disclosure circular and the actual franchise agreement. While the estimated start-up costs of the franchise are an implied "earnings claim" some businesses do fail, including franchised outlets. Unfortunately, the unit financial performance statistics are not required to be disclosed to new buyers of franchises and this omission makes it impossible for new buyers of franchises to assess the odds of success and failure of their investment in the franchise in terms of profitability and failure as experienced on a unit basis of the franchise system.

– **Control:** For franchisees, the main disadvantage of franchising is a loss of control. While they gain the use of a system, trademarks, assistance, training, marketing, the franchisee is required to follow the system and get approval for changes from the franchisor. For these reasons, franchisees and entrepreneurs are very different.

– **Price:** Starting and operating a franchise business carries expenses. In choosing to adopt the standards set by the franchisor, the franchisee often has no further choice as to signage, shop fitting, uniforms etc.

The franchisee may not be allowed to source less expensive alternatives. Added to that is the franchise fee and ongoing royalties and advertising contributions. The contract may also bind the franchisee to such alterations as demanded by the franchisor from time to time.

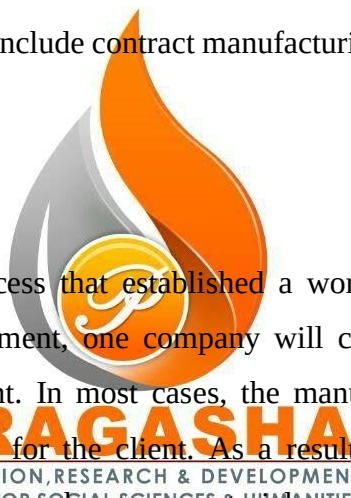
– **Conflicts:** The franchisor/franchisee relationship can easily cause conflict if either side is incompetent (or acting in bad faith). An incompetent franchisor can destroy its franchisees by failing to promote the brand properly or by squeezing them too aggressively for profits. Franchise agreements are unilateral contracts or contracts of adhesion wherein the contract terms generally are advantageous to the franchisor when there is conflict in the relationship.

SPECIAL MODES

These have special strategies and include contract manufacturing, management contracts and turnkey projects:

Contract Manufacturing

Contract manufacturing is a process that established a working agreement between two companies. As part of the agreement, one company will custom produce parts or other materials on behalf of their client. In most cases, the manufacturer will also handle the ordering and shipment processes for the client. As a result, the client does not have to maintain manufacturing facilities, purchase raw materials, or hire labor in order to produce the finished goods. The basic working model used by contract manufacturers translates well into many different industries. Since the process is essentially outsourcing production to a partner who will privately brand the end product, there are a number of different business ventures that can make use of a contract manufacturing arrangement. There are a number of examples of pharmaceutical contract manufacturing currently functioning today, as well as similar arrangements in food manufacturing, the creation of computer components and other forms of electronic contract manufacturing. Even industries like personal care and hygiene products, automotive parts, and medical supplies are often created under the terms of a contract manufacture agreement. There are several advantages to a contract manufacturing arrangement. For the manufacturer, there is the guarantee of steady work. Having contracts in place that commit to certain levels of production for one, two and even five year periods



makes it much easier to forecast the future financial stability of the company. For the client, there is no need to purchase or rent production facilities, buy equipment, purchase raw materials, or hire and train employees to produce the goods. There are also no headaches from dealing with employees who fail to report to work, equipment that breaks down, or any of the other minor details that any manufacturing company must face daily. All the client has to do is generate sales, forward orders to the manufacturer, and keep accurate records of all income and expenses associated with the business venture.

Management Contracts

A management contract is an arrangement under which operational control of an enterprise is vested by contract in a separate enterprise which performs the necessary managerial functions in return for a fee. Management contracts involve not just selling a method of doing things (as with franchising or licensing) but involves actually doing them. A management contract can involve a wide range of functions, such as technical operation of a production facility, management of personnel, accounting, marketing services and training. Management contracts have been used to a wide extent in the airline industry, and when foreign government action restricts other entry methods. Management contracts are often formed where there is a lack of local skills to run a project. It is an alternative to foreign direct investment as it does not involve as high risk and can yield higher returns for the company.

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Turnkey Projects

Turn-key refers to something that is ready for immediate use, generally used in the sale or supply of goods or services. The term is common in the construction industry, for instance, in which it refers to the bundling of materials and labour by sub-contractors. A "turnkey" job by a plumber would include the parts (toilets, tub, faucets, pipes, etc.) as well as the plumber's labour, without any contribution by the general contractors. This is commonly used in motorsports to describe a car being sold with drive train (engine, transmission, etc.) as a racer may prefer to keep the pieces to use in another vehicle to preserve a combination. Similarly, this term may be used to advertise the sale of an established business, including all the equipment necessary to run it, or by a business-to-business supplier providing complete

packages for business start-up. In a turnkey business transaction, different entities are responsible for setting up a plant or equipment (e.g. trains/infrastructure) and for putting it into operation. It can include contractual actions - at least through the system, subsystem, or equipment installation phase. It may also include follow-on contractual actions, such as testing, training, logistical, and operational support. It is often given to the best bidder in a procurement process. Turnkey projects can also be extended, known as turnkey plus, where there is perhaps a small equity interest by the supplier and it will later on continue its operation through a management contract or licensing. Turnkey is often used to describe a home built ready for the customer to move in. If a contractor builds a "turnkey home" they frame the structure and finish the interior. Everything is completed down to the cabinets and carpet.

FOREIGN DIRECT INVESTMENT WITHOUT ALLIANCES

Some companies enter the foreign markets through exporting, licensing, franchising etc., get the knowledge and awareness of the foreign markets, culture of the country, customers' preferences, political situation of the country etc and then establish manufacturing facilities by ownership in the foreign countries. Baskin Robbin's in Russia followed this strategy. In this arrangement, the international firm makes a direct investment in a production unit in a foreign market. It requires greatest commitment since there is 100% ownership. It is also called the Greenfield investment. The parent company starts a new venture in a foreign country by constructing new operational facilities from the ground up. In addition to building new facilities, most parent companies also create new long-term jobs in the foreign country by hiring new employees. Green field investments occur when multinational corporations enter into developing countries to build new factories and/or stores. Developing countries often offer prospective companies tax-breaks, subsidies and other types of incentives to set up green field investments. Governments often see that losing corporate tax revenue is a small price to pay if jobs are created and knowledge and technology is gained to boost the country's human capital.

FOREIGN DIRECT INVESTMENT WITH STRATEGIC ALLIANCES

Innovations, creations, productivity, growth, expansions and diversifications in recent years are mostly accomplished by strategic alliances adopted by various companies. Strategic alliances are a co-operative approach to achieve the larger goals. Strategic alliances can take different forms like licensing, franchising, contract manufacturing, JVs etc. Alliances are a strategy to explore a new market which the companies individually cannot do. Example: Xerox of USA and Fuji of Japan collaborated to explore new markets in Europe and Pacific Rim

Mergers and Acquisitions

International mergers and acquisitions are growing day by day. These mergers and acquisitions refer to those mergers and acquisitions that are taking place beyond the boundaries of a particular country. International mergers and acquisitions are also termed as global mergers and acquisitions or cross-border mergers and acquisitions. Globalisation and worldwide financial reforms have collectively contributed towards the development of international mergers and acquisitions to a substantial extent. International mergers and acquisitions are taking place in different forms, for example horizontal mergers, vertical mergers, conglomerate mergers, congeneric mergers, reverse mergers, dilutive mergers, accretive mergers and others. International mergers and acquisitions are performed for the purpose of obtaining some strategic benefits in the markets of a particular country. With the help of international mergers and acquisitions, multinational corporations can enjoy a number of advantages, which include economies of scale and market dominance. International mergers and acquisitions play an important role behind the growth of a company. These deals or transactions help a large number of companies penetrate into new markets fast and attain economies of scale. They also stimulate foreign direct investment or FDI. The reputed international mergers and acquisitions agencies also provide educational program sand training in order to grow the expertise of the merger and acquisition professionals working in the global merger and acquisitions sector. The rules and regulations regarding international mergers and acquisitions keep on changing constantly and it is mandatory that the parties to international mergers and acquisitions get themselves updated with the various amendments. Numerous investment bank professionals, consultants and attorneys are there to offer valuable and knowledgeable recommendations to the merger and acquisition clients.

Joint venture

A Joint Venture is an entity formed between two or more parties to undertake economic activity together. The parties agree to create a new entity to share in the revenues, expenses, and control of the enterprise. Joint ventures can be defined as "an enterprise in which two or more investors share ownership and control over property rights and operation". The venture can be for one specific project only, or a continuing business relationship. Entering into a joint venture is a major decision. Businesses of any size can use joint ventures to strengthen long-term relationships or to collaborate on short-term projects.

India's Foreign Trade: Policy and trends (International Business)

Foreign Trade is the important factor in economic development in any nation. Foreign trade in India comprises of all imports and exports to and from India. The Ministry of Commerce and Industry at the level of Central Government has responsibility to manage such operations. The domestic production reveals on exports and imports of the country. The production consecutively depends on endowment of factor availability. This leads to relative advantage of the financial system. Currently, International trade is a crucial part of development strategy and it can be an effective mechanism of financial growth, job opportunities and poverty reduction in an economy. According to Traditional Pattern of development, resources are transferred from the agricultural to the manufacturing sector and then into services.

Historical review: Foreign trade in India began in the period of the latter half of the 19th century. The period 1900-1914 saw development in India's foreign trade. The augment in the production of crops as oilseeds, cotton, jute and tea was mainly due to a thriving export trade. In the First World War, India's foreign trade decelerated. After post-war period, India's exports increased because demand for raw materials was increased in all over world and there were elimination of war time restrictions. The imports also increased to satisfy the restricted demand. Records indicated that India's foreign trade was rigorously affected by the great depression of 1930s because of decrement in commodity prices, decline in consumer's purchasing power and unfair trade policies adopted by the colonial government. During the Second World War, India accomplished huge export surplus and accumulated substantial

amount of real balances. There was a huge pressure of restricted demand in India during the Second World War. The import requirements were outsized and export surpluses were lesser at the end of the war. Before independence, India's foreign trade was associated with a colonial and agricultural economy. Exports consisted primarily of raw materials and plantation crops, while imports composed of light consumer merchandise and other manufactures. The structure of India's foreign trade reflected the organized utilization of the country by the foreign leaders. The raw materials were exported from India and finished products imported from the U.K. The production of final products were discouraged. For instance, cotton textiles, which were India's exports, accounted for the largest share of its imports during the British period. This resulted in the decline of Indian industries. Since last six decades, India's foreign trade has changed in terms of composition of commodities. The exports included array of conventional and non-traditional products while imports mostly consist of capital goods, petroleum products, raw materials, intermediates and chemicals to meet the ever increasing industrial demands. The export trade during 1950-1960 was noticeable by two main trends. First, among commodities which were directly based on agricultural production such as tea, cotton textiles, jute manufactures, hides and skins, spices and tobacco exports did not increase on the whole, and secondly, there was a significant boost in the exports of raw manufactures such as iron ore. In the period of 1950 to 1951, main products dominated the Indian export sector. These included cashew kernels, black pepper, tea, coal, mica, manganese ore, raw and tanned hides and skins, vegetable oils, raw cotton, and raw wool. These products comprised of 34 per cent of the total exports. In the period of 1950s there were balance of payments crunch. The export proceeds were not enough to fulfil the emerging import demand. The turn down in agriculture production and growing pace of development activity added pressure. The external factors such as the closure of Suez Canal created tension on the domestic financial system. The critical problem at that moment was that of foreign exchange scarcity. The Second Five Year Plan with its emphasis on the development of industry, mining and transport had a large foreign exchange factor. This tension on the balance of payments required the stiffening of import strategy at a later stage.

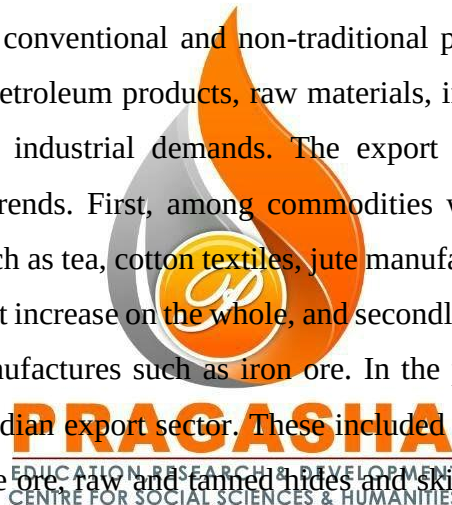


Table: Measures initiated in India to Influence Foreign Trade during 1949-1950 to 1979-1980

Source: Inputs from various issues of Economic Survey, Ministry of Finance, Government of India, New Delhi

Plans	Policy Measures
First Plan	The desire to save foreign exchange reserves was expressed in the first five year plan (1951-1956). To control and regulate exports and imports in the certain select commodities state trading was considered necessary plan.
Second Plan	Since the middle of second five year plan (1956-1961) a series of measures were initiated with the objective of stepping up exports. The measures in questions were fairly widely conceived and included organizational changes, increased facilities and incentives and diversification of trade.
Third Plan	The third five year plan (1961-1965) provided various measures for expanding exports. The plan divided the expanding of exports under two groups namely. 1. General policies



	2. Measures relating to specific commodities. Further the third five year plan asked for the availability of surpluses for exports at prices competitive with those of other suppliers in international markets. The third plan tried to explore the possibility of supplementing export earnings with external assistance.
Annual Plan	The three Annual Plans (1966-1969) began with the devaluation of rupee on 6th June 1966 to solve the balance of payment problems and trade problem. This was followed by import liberalization policies. The principal policy measures taken with devaluation included liberal import policy for 59 priority industries in which arrangements were made to meet the requirements for raw materials, components and spares in full (Initially for six months). Further modifications, adjustments and extensions in export policies were initiated.



Fourth Plan	The Fourth five year plan (1969-1974) stated that export quotas should be kept to the minimum, specially in case of primary agricultural products, unless there were overriding considerations to justify such action. The fourth plan laid stress on adequate provision for modernization and rehabilitation of manufacturing units as part of export promotion efforts in case of traditional exports. For increasing exports of non-traditional items, special emphasis was placed on wider publicity.
Fifth Plan	In order to have sustained level of growth rate of exports during the fifth five year plan (1974-1979), the exploitation of both supply and demand were considered necessary for export of products of manufacturing sector. This plan laid emphasis on tapping markets where India enjoyed distinct locational advantages.

In the age of globalisation, India is new entrant to expand international trend. In 1991, the government initiated some changes in its strategy on trade, foreign Investment, Tariffs and Taxes under the name of "New Economic Reforms". Indian government mainly concentrated on reforms on Liberalization, openness and export sponsorship activity. It is witnessed that

foreign Trade of India has considerably revolutionized export in the Post reforms period. Trade Volume increased and the composition of exports has undergone several noteworthy changes. In Post - reform Period, the major provider to export's growth has been the manufacturing sector.

Though India has steadily opened up its wealth, its tariffs are high as compared with other countries, and its conjecture norms are still restricted. Foreign trade in India in legal term is the Foreign Trade (Development and Regulation) Act, 1992. The Act provide with the development and regulation of foreign trade by assisting imports into, and supplementing exports from India. To fulfil the requirements of the Act, the government may make necessities for assisting and controlling foreign trade, may forbid, confine and regulate exports and imports, in all or particular cases as well as subject them to exclusion. Government is endorsed to devise and declare an export and import policy and also amend the same from time to time, by notification in the Official Gazette, and is also authoritative to appoint a 'Director General of Foreign Trade' for the purpose of the Act, including formulation and accomplishment of the export-import policy.

The 15X15 Matrix Strategies was introduced in 1995 and major aim of this policy was to recognize market diversification and commodity diversification. When reviewed the success of this, it represented that the share of the total top 15 product groups exported to the top 15 market destinations declined from 71% in 1996-97 to 66% in 2000-01 in respect of the total export of these 15 product groups for all destinations taken together. It clearly showed the market diversification for these product groups. The major items of India's exports controlled in the Matrix continue to remain the same during 2000 - 01 such as Gems and Jewellery, RMG Cotton including accessories and Cotton Yarn, Fabrics and Made Ups. The top three destinations changed from US, UK and Japan to US, Hong Kong and UAE. Another strategy was Focus LAC which was introduced in 1997 in order to enhance exports of chosen products such as Textiles including RMG, Engineering goods and Chemical products to Latin American Region. The highest growth rate of exports to this region was accomplished during period of 2000-01 when the value of exports was high of US\$ 982 million. Though the current trade between LAC and India is still low, there is possibility to increase two-way trade between India and the LAC region. It is observed from the export strategies of previous time

is that the composition, competitiveness and complexion of world products trade are changing rapidly and there is a need to review the market constantly for any medium term export strategy to achieve a higher share of global exports on a sustainable basis. The main concentration of previous foreign trade strategies was on the existing export products of India.

Nonetheless, presently, the government has made policy on trade and investment policy that has established an obvious change from protecting 'producers' to benefiting 'consumers'. It is reflected in its foreign trade strategy of India for 2004/09 which indicated that "for India to become a major player in world trade we have also to make possible those imports which are required to stimulate our economy". With numerous economic alterations, globalisation of the Indian economy has been the foremost factor to formulate the trade policies. The announcement of a new Foreign Trade Policy of India for a five year period of 2004-09, substituting until now taxonomy of EXIM Policy by Foreign Trade Policy is major step in the development of foreign trade policy. This policy made the overall development of India's foreign trade and offers guidelines for the development of this sector. Main purpose of the Exim Policy is to hasten the economy from low level of economic activities to high level of economic activities by making it a globally oriented energetic economy and to derive maximum benefits from expanding global market opportunities, to encourage continued economic growth by providing access to essential raw materials, intermediates, components, consumables and capital goods required for augmenting production, to boost the techno local strength and efficiency of Indian agriculture, industry and services, thereby, improving their competitiveness, to generate new employment and opportunities and encourage the attainment of internationally accepted standards of quality. Finally, this policy provides quality consumer products at reasonable prices. A vibrant export-led growth strategy of doubling India's share in global commodities trade with an attention on the sectors having prospects for export development and potential for employment generation, represent the main factor of the policy. These activities augment India's international competitiveness and assist in increasing the suitability of Indian exports. The trade policy recognizes major strategies, outlines export incentives, and also focus on issues relating to institutional support including simplification of procedures relating to export activities. India is now violently pushing for a more moderate global trade management, especially in services. It has

understood a leadership role among developing nations in global trade debates, and played a decisive part in the Doha negotiations. With economic reforms, globalisation of the Indian economy has been the major factor in devising the foreign trade policy of India.



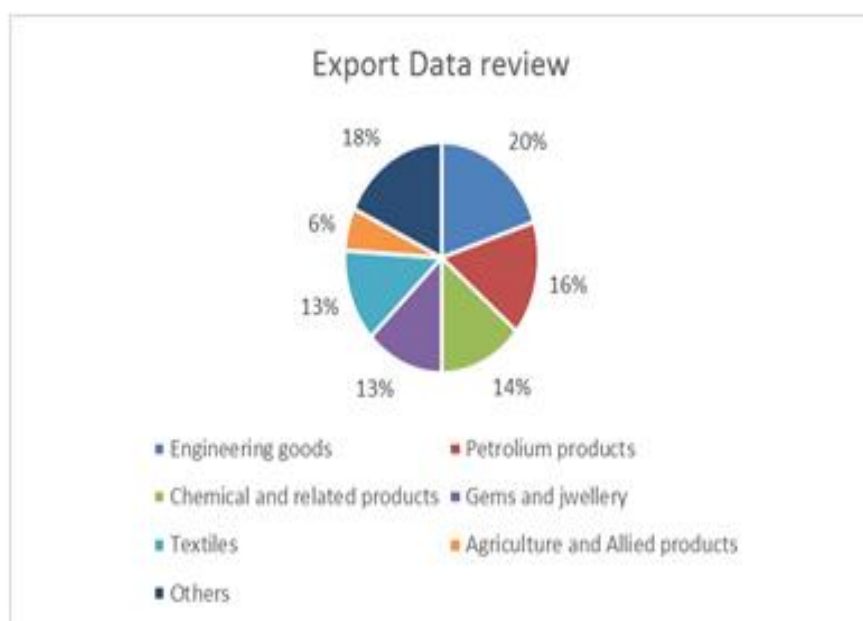
Periods	Policy Measures
1990-1991	i) New Import –Export policy was formulated. ii) Services exports were encouraged. iii) Replenishment rates were modified to encourage higher value added products.
1992-1993	i) EXIM policy for five years 1992-1997 was implemented. ii) Since 1992 imports were regulated through a limited negative list.
1994-1995	Under the Duty Exemption Scheme and the Export Promotion of Capital Goods scheme third party exports were given benefits.
1995-1996	i) Quantitative restrictions were phased out in the form of licensing and other discretionary controls. ii) More than 3000 tariff lines covering raw materials, intermediates and capital goods were freed of import licensing requirements. iii) Controls on imports were liberalised with only small list of items in negative list.
1997-1998	EXIM Policy 1997-2002 constituted.
1998-1999	i) In wake of the adverse impact of Asian crisis on India's exports , various measures were announced in August and September 1998, such as: a) Exports under all export promotion schemes were exempted from Special Additional Duty. b) Simplification of bond-furnishing procedures for exporters. c) Tax holiday for EOU/EPZ to 10 years, etc.

1999-2000	i) Import of 894 items was made license free and another 414 items were allowed to be imported against Special Import License. ii) Free Trade Zones replaced Export Processing Zones. iii) Green card for exporters exporting 50% of their production. iv) Duty free imports of consumables up to certain limits for gems and jewellery, handicrafts and leather sectors. v) Golden status certificates for Export and Trading Houses.
2001-2002	i) Quantitative restrictions removed from 714 tariff lines . ii) Setting up of Special Economic Zones.
2002-2003	Agricultural exports promoted.
2006-2007	Efforts were made to make India hub of gems and jewellery by accelerating their exports.
2008-2009	i) Continued emphasis on Special Economic Zones. ii) Exports duty on Iron ore fines was eliminated.
2010-2011	i) 27 new markets added under the Focus Market Scheme (FMS) with incentive of duty credit scrip at 3% of exports. ii) The Zero duty Export Promotion Capital Goods Scheme and Status Holder Incentive Scrip Scheme introduced in 2009 for limited sectors and valid only for two years initially, extended by one more year till 31 March, 2012 and the benefit of scheme expanded to other sectors.

Source: Inputs from various issues of Economic Survey, Ministry of Finance, Government of India, New Delhi.

The objective of the Foreign Trade Policy is to twofold India percentage share of global merchandise trade and to act as an effectual instrument of economic growth by giving a thrust to employment generation, especially in semi-urban and rural areas. The growth performance of exports has been a result of watchful effort of the Government to lessen transaction costs and assist trade. The guidelines of the Foreign Trade Policy (2004-09) for a five year period clearly articulate objectives, strategies and policy initiatives that has been involved in putting exports on a higher growth line.

Reviewing data of exports by Principal Commodities for the period April - October 2006-07, the export growth was largely driven by petroleum products, engineering. Export of other products like Agriculture and Allied Products, Ores and Minerals, Leather and Leather Manufactures, Gems and Jewellery, Chemicals and related Products, Engineering Goods and other commodities are shown below:



Export Data Review

There are numerous challenges and issues in foreign trade. These include burden of export promotion schemes, danger of circular trading, and risk of importing outdated machinery.

Sometimes policy fails to take a holistic view of trade issues. Other issue is relative importance of the home market, the nature or the degree of State intervention and recessionary conditions in the global market. India's exports have suffered due to structural constraints operating both on the demand and supply side. On the demand side exports have continued to undergone the problems of adverse world trading environment, protectionist sentiments in the developed countries in the guise of technical standards, environmental and social concerns and tariff differentials in imports by the developed countries. At the supply end, the factors that have constrained exports from India include infrastructure constraints, high transaction costs, inflexibilities in labour laws, quality problems, constraints in attracting FDI in the export sector, etc

It is summarized that foreign trade has significant function in the fiscal development of any nation. India has made strong foreign trade policies and reformed these from time to time with the process of globalisation and liberalization. Since 1991, India's foreign trade considerably transformed. India's major exports include manufacturing and engineering goods. India has good trading relations with all developed countries in the world. More than fifty percent of India's total export trade is with Asia and ASEAN region and about sixty percent of India's total imports is with the same countries. India's wealth previously was agricultural economy. India's major requirement use to be food grains and other goods in import with fast industrialization, the composition of India's imports goods changed and needed chemicals, fertilizers and machinery which were required to meet the developmental requirements of country. In the composition of export; country sells agricultural products such as tea, spices, and other raw materials. However, with the industrialization of the financial system, compositions of exports changed. Currently, India exports products such as machinery chemicals and marine products. This may enhance the fiscal condition of India.

Introduction to FTP

- ☐ Foreign trade policies deal with the policies of the national governments relating to exports of various goods and services to various countries either on equal terms and conditions or on discriminatory terms and conditions.
- ☐ Trade policies also aim at protecting the domestic industry from the competition of advanced countries through imposing quotas. Trade policies of some countries aim at

building competencies of the domestic companies by providing subsidies. Thus the countries announce trade policies from time to time. An understanding of these policies enable the MNCs to formulate their strategies regarding entry and conduct of business in various countries.

☐ Government announce their trade policies with regard to the following from time to time. These are also called the instruments of trade policy. They are:

☐ Tariffs

☐ Subsidies

☐ Import Quotas

☐ Voluntary Export Restraints

☐ Local Content Requirements and

☐ Administrative Policies

Tariffs:

☐ Tariffs refers to the tax imposed on imports. Tariffs are of two types, viz., specific tariffs and ad valorem tariffs.

☐ The tariff levied as a proportion of the value of the imported goods is called 'ad valorem' tariff.

☐ The purpose of tariffs is to protect the domestic industry by increasing the cost of imported goods. Government of India imposed tariffs to protect domestic automobile industry, sugar industry, cement industry and steel industry.

Subsidies:

In order to encourage domestic production or to protect the domestic producer from the foreign competitors, government pays to a domestic producer by reducing operations cost. Such payments are called subsidies. Subsidies are in different forms. They are: cash



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grants, loans and advances at low rate of interest, tax holidays, government procurement of output at a higher rate, equity participation and supply of inputs at lower prices.

Import Quotas:

Import quota is direct restriction on the quantity of goods which are imported into a country. These restrictions are imposed by issuing. Import licenses to certain firms and individuals to import certain quantity of the goods. India had quotas of imports of various goods like cars, motor cycles, milk etc. upto 31st March 2001. Import quotas provide the protection to the domestic firms from the foreign competitors.

Voluntary Export Restraints:

A voluntary export restraint is the opposite form of import quotas. A voluntary export restraint is a quota on exports of the domestic firm imposed by the exporting country. Exporting country imposes such restriction, mostly at the request of the importing country. For example, Japanese automobile exporters had such restraint in 1981 due to the request of the US government. Foreign exporters mostly accept for the voluntary export restraint as its violation leads to imposition of import tariffs, import quotas etc.

Import quotas and voluntary export restraints help the domestic firms by providing protection from the foreign competitors. These enhance the prices of import goods and make the domestic goods cheap.

Another form of restrictions imposed on the imports is the local content requirements.

Local Content Requirements:

Local content requirement is a condition that requires some specific fraction of a product imported be produced domestically. The requirement may be in physical terms (50% of the components should be from the domestic country) or in value terms (50% of the value of the product should be produced domestically.)

Most of the developing countries insist on the local content requirements in order to shift at least certain part of manufacturing base in their country. This helps the country to

enhance the employment opportunities, utilisation of local resources and economic activities.

This factor protects the domestic producer as in case of quotas.

Administrative Policies:

Governments, in addition to the quotas and other restrictions, use formal and informal policies to restrict imports and boost exports. Administrative policies are bureaucratic rules and procedures which are formulated to make it difficult to imports to enter the country. Formal trade barriers like tariffs and quotas are lowest in Japan. Japan mostly uses the administrative policies.

It is a quite a contradicting issue to study trade policies in these days of globalisation. Some argue that government should intervene in formulating trade policies while others reject it. As such, we now analyse the argument for government intervention in formulating trade policies.

International Economic Relations:

Trade among nations had developed over the period. Later, the nations have started cooperating among themselves by establishing various economic organisations like banks, industries, business firms in various countries. These developments over the period led to the formulation of various economic policies like tariffs policy, international cartels, intergovernmental commodity agreements, dumping and preemptive buying, quotas and licenses, state trading and subsidies etc.

1. Tariffs Policy:

Tax or duty imposed on imports and exports is called tariffs. Tariffs are levied for protecting domestic industry from the competition of foreign companies and / or for earning revenue to

the government. Tariff policy deals with the purpose of tax rates and structure of tax etc. Rates and structure vary from country to country and from product to product.

Tariffs protect domestic industry and also enhance inefficiency. They increase the prices of products or goods. The trend of protectionalism has continued since World War II. Formation of trading blocks or regional groupings reduced the trend of tariffs. Further, the formation of General Agreement on Tariffs and Trade (GATT) and subsequent establishment of World Trade Organisation are the trends towards the elimination of tariffs.

2. International Cartels:

Companies carrying out the same business join together in order to avoid competition among themselves in order to exert monopolistic influence over price, quality and quantity of production. Cartels were prominent in Germany in 19th century.

International cartels are the agreements among companies or countries, carrying out the same business but located in different countries in order to exert monopolistic competition. Examples of international cartels are: Organisation of Petroleum Exporting Countries and International Air Transport Association.

3. International Commodity Agreements:

Countries producing the same products and exporting to the same countries enter into an agreement in order to avoid competition among themselves. Such Agreements are referred to as 'International commodity agreements'. International commodity agreements use different techniques like buffer stock agreements and price controls, in order to attain their objectives.

4. Dumping:

It means selling the products at a price less than the on going price in the market or less than the cost of production. Dumping is used to sell the excess production or to earn foreign exchange. Germans and Japanese used dumping during World War II. Presently China is dumping its products in Indian Market. The importing countries impose anti-dumping duties in order to protect the domestic industry from dumping.

5. Pre-emptive Buying:

During the war crisis countries buy the goods from the neutral countries in order to depriving the enemy from having the products needed by them.

6. Quotas and Licences:

Quotas are quantitative controls imposed by the importing country on import of goods. Quantitative restrictions or quotas are to protect the domestic industry from the foreign competitors. However, quotas make the domestic industry inefficient.

7. State Trading:

It is the trading (exports and imports) performed by the government. Government performs the trading in a limited number of goods and services.

8. Embargoes:

It may prohibit the shipment of all goods to a particular country or to a group of countries.

9. Boycotts:

It is the opposite of embargo and it stops the imports from a country or a group of countries.

International Logistics Supply Chains ride on Logistics Networks and IT Applications / Internet. In this topic a brief introduction to each of the Logistics Function/Industry is attempted.

The foundation of logistics function is based mainly on Transportation by Road, Rail, and Air & Sea.

Maritime trade has existed since times immemorial. History is replete with the major maritime routes that connected continents across the globe and enabled trade between them. Harbors and waterways have flourished in strategic locations in all countries attracting trade and commerce.

Global trade is dependant 80% on sea route than air route, simply for the fact that air route is far more expensive and is used only in case of light weight cargo, perishable cargo, and priority shipments or in other conditions where shipping would not be possible.



Shipping trade is characterized by shipping companies who own vessels and specialize in the transportation of certain types of cargo like General Cargo, Containerized cargo, bulk commodities carriers, oil tankers, gas tankers, OD cargo carriers, etc. Normally the so called mother vessels ply on the main shipping route across the continents traveling through Pacific or Atlantic oceans and calling on countries from point to point. Mother vessels are bigger vessels with higher cargo carrying capacity. Some of the main routes normally traversed by mother vessels are the Far East to Europe and Mediterranean, Europe to America East Coast and the Gulf of Mexico, Far East Australia to South Africa, Intra Asia, Asia to the Middle East, and Europe to South Africa, etc. The schedules in detail are announced in advance for each of the vessels. The feeder vessels carry cargo from individual ports in nearby countries which discharge the cargo at the port of calling to be transshipped on to the main vessel.

Thus for example, a cargo originating in India bound for South Africa may follow the route where cargo reaches one of the ports in Ceylon or Dubai even Singapore in some cases and travels right up to Europe where it is further transshipped on another vessel bound to South Africa. Like wise the global shipping trade lanes have certain gateways and lanes which they operate and in turn are fed and supported by feeder lanes and vessels.

Shipping liner announces schedules of the vessels a few months in advance. Freight forwarding agents book space on the vessels either based on estimates or based on their pipeline orders. Depending upon the volume that the forwarder is able to give and patronize shipping lines, they get to bargain and negotiate for better rates. In general cargo, the shipments are made in FCL Containers. FCL stands for Full Container Load. FCLs come in two sizes called 20 feet and 40 feet containers which refers to the length of the container. Each container has fixed dimension and weight carrying capacity. FCL Containers are provided by shipping lines to the freight forwarders who stuff the cargo and get the cargo sealed after customs inspection which is then picked up and loaded on the ship at the port.

Some of the major international shipping lines dominated world shipping trade is P&A, Nedlloyd, Maersk, Hapag Lloyd, American President Lines, Evergreen, NYK, HanJin, Cosco, CSCL etc.

INTERNATIONAL FINANCIAL MANAGEMENT

Financial management of a company is a complex process, involving its own methods and procedures. It is made even more complex because of the globalization taking place, which is making the world's financial and commodity markets more and more integrated. The integration is both across countries as well as markets. Not only the markets, but even the companies are becoming international in their operations and approach. Managers of international firms have to understand the environment in which they function if they are to achieve their objective in maximizing the value of their firms, or the rate of return from foreign operations. The environment consists of: 1. The international financial system, which consists of two segments: the official part represented by the accepted code of behavior by governments comprising the international monetary system, and the private part, which consists of international banks and other multinational financial institutions that participate in the international money and capital markets. 2. The foreign exchange market, which consists of multinational banks, foreign exchange dealers, and organized exchanges where currency futures are regularly traded. 3. The foreign country's environment, consisting of such aspects as the political and socioeconomic systems, and people's cultural values and aspirations. Understanding of the host country's environment is crucial for successful operation and essential for the assessment of the political risk.

The multinational financial manager has to realize that the presence of his firm in a number of countries and the diversity of its operations present challenges as well as opportunities. The challenges are the unique risks and variables the manager has to contend with which his or her domestic counterpart does not have to worry about. One of these challenges, for example, is the multiplicity and complexity of the taxation systems, which impact the MNC's operations and profitability. But this same challenge presents the manager with opportunities to reduce the firm's overall tax burden, through transfer of funds from high- to low-tax affiliates and by using tax havens. The financing function is another such challenge, due to the multiplicity of sources of funds or avenues of investment available to the financial manager. The manager has to worry about the foreign exchange and political risks in positioning funds and in mobilizing cash resources. This diversity of financial sources enables the MNC at the same time to reduce its cost of capital and maximize the return on its excess cash resources, compared to firms that raise and invest funds in one capital market. In a real sense MNCs are particularly situated to make the geographic, currency, and institutional diversity work for them. This diversity, if properly managed, helps to reduce fluctuations in their earnings and cash flows, which

would translate into higher stock market values for their shares. This observation is especially valid for the well-diversified MNCs. This is not to suggest that the job of the manager of an MNC is easier, or less demanding, than if he or she were to operate within the confines of one country. The challenges and the risks are greater, but so are the rewards accruing to intelligent, flexible, and forward-looking management. The key to such a management is to make the diversity and complexity of the environment work for the benefit of the firm and to lessen the adverse impact of conflicts on its progress.

Factors affecting the F M

1. Interest Rates

"Benchmark" interest rates from central banks influence the retail rates financial institutions charge customers to borrow money. For instance, if the economy is under-performing, central banks may lower interest rates to make it cheaper to borrow; this often boosts consumer spending, which may help expand the economy. To slow the rate of inflation in an overheated economy, central banks raise the benchmark so borrowing is more expensive. 2Economic Growth and health

Reports such as Employment levels, retail sales ,GDP ,capacity utilization detail the levels of a country economic growth and health.

3 balance of trade: A country's balance of trade is the total value of its exports, minus the total value of its imports. If the country exports are greater than imports than the BOT is favorable another unfavorable. Favorable balance increases the demand of currency because foreign buyers must exchange more of their home currency in order to buy its goods. A trade deficit, on the other hand, increases the supply of a country's currency and could lead to devaluation if supply greatly exceeds demand.

4Employment Outlook

Employment levels have an immediate impact on economic growth. As unemployment increases, consumer spending falls because jobless workers have less money to spend on non-essentials. Those still employed worry for the future and also tend to reduce spending and save more of their income 5 Inflation levels and trade: a currency will loose value if

there is high level of inflation in the country because inflation erodes the purchasing power.

Exchange Risk

A collection of risks associated with investing in a foreign country. These risks include political risk, exchange rate risk, economic risk, sovereign risk and transfer risk, which is the risk of capital being locked up or frozen by government action. Country risk varies from one country to the next. Some countries have high enough risk to discourage much foreign investment. Country risk can reduce the expected return on an investment and must be taken into consideration whenever investing abroad. Some country risk does not have an effective hedge. Other risk, such as exchange rate risk, can be protected against with a marginal loss of profit potential. The United States is generally considered the benchmark for low country risk and most nations can have their risk measured as compared to the U.S. Country risk is higher with longer term investments and direct investments, which are investments not made through a regulated market or exchange.

Economic and Political Risk The following are two main sources of risk that need be considered when investing in a foreign country. **Economic risk:** This risk refers to a country's ability to pay back its debts. A country with stable finances and a stronger economy should provide more reliable investments than a country with weaker finances or an unsound economy. **Political risk:** This risk refers to the political decisions made within a country that might result in an unanticipated loss to investors. While economic risk is often referred to as a country's ability to pay back its debts, political risk is sometimes referred to as the willingness of a country to pay debts or maintain a hospitable climate for outside investment. Even if a country's economy is if the political climate is unfriendly (or becomes unfriendly) to outside investors, the country may not be a good candidate for investment.

IMPORTANT FACTOR THAT EFFECT THE RISK PROFILE OF INTERNATIONAL TRANSACTION

Forex market is one of the largest financial markets in the world, where buyers and sellers conduct foreign exchange transactions. Its important in the international trade can be estimated with the fact that average daily trade in the global forex markets is over US \$ 3

trillion. We shall touch upon some important topics that affect the risk profile of an International transaction.

Spot Rate

Also known as "benchmark rates", "straightforward rates" or "outright rates", spot rates is an agreement to buy or sell currency at the current exchange rate. The globally accepted settlement cycle for foreign exchange contracts is two days. Foreign exchange contracts are therefore settled on the second day after the day the deal is made.

Forward Price

Forward price is a fixed price at which a particular amount of a commodity, currency or security is to be delivered on a fixed date in the future, possibly as far as a year ahead. Traders agree to buy and sell currencies for settlement at least three days later, at predetermined exchange rates. This type of transaction often is used by business to reduce their exchange rate risk.

Forward Price vs. Spot Price

Theoretically it is possible for a forward price of a currency to equal its spot price. However, interest rates must be considered. The interest rate can be earned by holding different currencies usually varies, therefore forward price can be higher or lower than (at premium or discount to) the spot prices.



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RBI Reference Rate

The reference rate given by RBI is based on 12 noon rates of a few selected banks in Mumbai.

Inter Bank Rates

Interbank rates quote the bank for buying and selling foreign currency in the inter bank market, which works on wafer thin margins. For inter bank transactions the quotation is up to four decimals with the last two digits in multiples of 25.

Telegraphic Transfer

Telegraphic transfer or in short TT is a quick method of transfer money from one bank to another bank. TT method of money transfer has been introduced to solve the delay problems caused by cheques or demand drafts. In this method, money does not move physically and order to pay is wired to an institutions' cashier to make payment to a company or individual. A cipher code is appended to the text of the message to ensure its integrity and authenticity during transit. The same principle applies with Western Union and Money Gram.

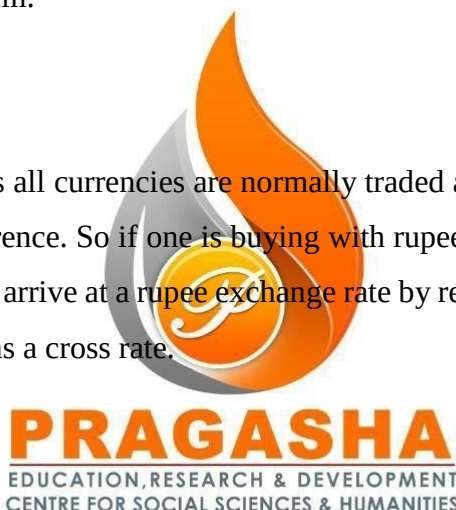
Currency Rate

The Currency rate is the rate at which the authorized dealer buys and sells the currency notes to its customers. It depends on the TC rate and is more than the TC rate for the person who is buying them.

Cross Rate

In inter bank transactions all currencies are normally traded against the US dollar, which becomes a frame of reference. So if one is buying with rupees a currency X which is not normally traded, one can arrive at a rupee exchange rate by relating the rupee \$ rate to the \$X rate . This is known as a cross rate.

Long and Short



When you go long on a currency, its means you bought it and are holding it in the expectation that it will appreciate in value. By contrast, going short means you reselling currency in the expectation that what you are selling will depreciate in value.

Bid and Ask

Bids are the highest price that the seller is offering for the particular currency. On the other hand, ask is the lowest price acceptable to the buyer. Together, the two prices constitute a quotation and the difference between the price offered by a dealer willing to sell something and the price he is willing to pay to buy it back.

Buying and Selling

In terms of foreign exchange, buying means purchasing a certain amount of the foreign currency at the bid or buying price against the delivery /crediting of a second currency which is also called counter currency. On the other hand, selling refers to a fix amount of foreign currency at the offered or selling price against the receipt / debiting of another currency.

FOREX Rates vs. Interest Rates

Forex rates or exchange rate is the price of a country's currency in terms of another country's currency. It specifies how much one currency is worth in terms of the other. For example a forex rate of 123 Japanese yen (JPY, ¥) to the United States dollar (USD, \$) means that JPY 123 is worth the same as USD 1. Choice of currency and its interest rate is a major concern in the international trade. Investors are easily attracted by the higher interest rates which in turns also effects the economy of a nation and its currency value. For an example, if interest rate on INR were substantially higher than the interest rate on USD, more USD would be converted into INR and pumped into the Indian economic system. This would result in appreciation of the INR, resulting in lower conversion rates of USD against INR, at the time of reconversion into USD.

FOREIGN EXCHANGE MARKET

The foreign exchange market assists international trade and investment by enabling currency conversion. For example, it permits a business in the United States to import goods from the European Union member states especially Euro zone members and pay Euros, even though its income is in United States dollars. The foreign exchange market (forex, FX, or currency market) is a form of exchange for the global decentralized trading of international currencies. Characteristics of foreign exchange market Electronic market Geographical Dispersal Transfer of purchasing power Intermediary Volume Provision of credit Minimizing Risk.

MARKET PARTICIPATES OF FOREIGN EXCHANGE MARKET

The foreign exchange market assists international trade and investment by enabling currency conversion. For example, it permits a business in the United States to import goods from the European Union member states especially Euro zone members and pay

Euros, even though its income is in United States dollars. The foreign exchange market (forex, FX, or currency market) is a form of exchange for the global decentralized trading of international currencies.

Market participants

Commercial Bank: A commercial bank (or business bank) is a type of financial institution and intermediary. It is a bank that lends money and provides transactional, savings, and money market accounts and that accepts time deposit in order to facilitate international trade and development, commercial banks convert and trade foreign currencies. When a company is doing business in another country it may be paid in the currency of that country. While some of these revenues will be used to pay workers in that country and for administrative expense such as office rent, utilities and supplies, the company may need to purchase goods from a neighboring country in that country's currency, or convert cash to its native currency for return to the home office.

Central bank: National central banks play an important role in the foreign exchange markets. They try to control the money supply, inflation, and/or interest rates and often have official or unofficial target rates for their currencies. They can use their often substantial foreign exchange reserves to stabilize the market.

Foreign exchange fixing Foreign exchange fixing is the daily monetary exchange rate fixed by the national bank of each country. The idea is that central banks use the fixing time and exchange rate to evaluate behavior of their currency. Fixing exchange rates reflects the real value of equilibrium in the market. Banks, dealers and traders use fixing rates as a trend indicator.

Hedge funds as speculators: About 70% to 90% of the foreign exchange transactions are speculative. In other words, the person or institution that bought or sold the currency has no plan to actually take delivery of the currency in the end; rather, they were solely speculating on the movement of that particular currency. Hedge funds have gained a reputation for aggressive currency speculation since 1996. They control billions of dollars of equity and may borrow billions more, and thus may overwhelm intervention by central banks to support almost any currency, if the economic fundamentals are in the hedge funds' favor.

Investment management firms: Investment management is the professional management of various securities (shares, bonds and other securities) and assets (e.g., real estate) in order to meet specified investment goals for the benefit of the investors. These firms (who typically manage large accounts on behalf of customers such as pension funds and endowments) use the foreign exchange market to facilitate transactions in foreign securities

Retail foreign exchange traders: One of the most important tools required to perform a foreign exchange transaction is the trading platform providing retail traders and brokers with accurate currency quotes. Retail foreign exchange trading is a small segment of the large foreign exchange market.

Financial instruments

Spot :. A foreign exchange spot transaction, also known as FX spot, is an agreement between two parties to buy one currency against selling another currency at an agreed price for settlement on the spot date. The exchange rate at which the transaction is done is called the spot exchange rate.

Forward : The forward market is the informal over-the-counter financial market by which contracts for future delivery are entered into. Over-the-counter (OTC) or off-exchange trading is done directly between two parties, without any supervision of an exchange.

Future : Standardized forward contracts are called futures contracts and traded on a futures exchange. a futures contract (more colloquially, futures) is a standardized contract between two parties to buy or sell a specified asset of standardized quantity and quality for a price agreed upon today (the futures price or strike price) with delivery and payment occurring at a specified future date. Swap : a foreign exchange swap, forex swap, or FX swap is a simultaneous purchase and sale of identical amounts of one currency for another with two different value dates (normally spot to forward). Option : A foreign exchange option (commonly shortened to just FX option) is a derivative where the owner has the right but not the obligation to exchange money denominated in one currency into another currency at a pre-agreed exchange rate on a specified date. The options market is the deepest, largest and most liquid market for options of any kind in the world.

WORLD TRADE ORGANISATION

General Agreement on Tariffs and Trade (GATT)

The prolonged recessions before the World War II in the West were due to the prolonged protectionism followed by the industrialized countries. This led to conduct of negotiations in 1947 among 23 countries in order to prevent the protectionism policies and to revive the economies from the recession. These negotiations of the conference resulted in the General Agreement on Tariffs and Trade (GATT) among the participated countries. Thus GATT has its origin in 1947 at a conference in Geneva.

The objectives of GATT are:

- ☐ To raise standard of living
- ☐ To ensure full employment and a large and steadily growing volume of real income and effective demand.
- ☐ To develop the full use of the resources of the world, and
- ☐ To expand production and international trade.

Several rounds of negotiations were held since the inception of GATT. The nature of the negotiations in the rounds during 1947 to 1960 was tariffs. The negotiation in other rounds included anti-dumping measures etc. The significant round is the Uruguay round of 1986. The nature of the issues in this round includes bringing agricultural and protection of intellectual property rights under GATT.

Uruguay Round

Uruguay Round of multilateral trade negotiations was initiated in September 1986 and concluded on 15th September 1993. Mr. Arthur Dunkel, the then Director General of GATT submitted a proposal on 20th December 1991 popularly known as Dunkel Proposals which envisages trade liberalisations in many areas like trade related investment measures (TRIMs), trade related intellectual property rights (TRIPs), other services, textiles, clothing and agriculture subsidies. An agreement regarding multilateral trading system was finally signed in Marrakesh, Morocco, on 15th April, 1994.

Establishment of World Trade Organisation (WTO):

In order to implement the final act of Uruguay Round agreement of GATT the World Trade Organisation (WTO) was established on January 1, 1995.

India is one of the (out of 104) founder members of the WTO. WTO is designed to play the role of watchdog in the spheres of trade in goods, trade in services, foreign investment, intellectual property rights etc. Its functions are set out in Article III are:

- The WTO shall facilitate the implementation, administration and operation and further the objectives of this agreement and on the Multinational Trade Agreements and shall also provide the framework for implementation, administration and operation of the plurilateral Trade Agreements.
- The WTO shall provide the forum for negotiation among its members concerning their multilateral trade relations in matters dealt with under the Agreements in the Annexes to this agreement.
- The WTO shall administer the understanding on Rules and Procedure Governing the Settlement of Disputes.
- The WTO shall administer the Trade Policy Review Mechanism, with a view to achieving greater coherence in global economic policy-making, the WTO shall co-operate, as appropriate, with the International Monetary Fund and with the International Bank for Reconstruction and Development and its affiliated agencies



World Trade Organisation and Anti-Dumping Measures:

Dumping means selling the product at below the on-going market price and / or at the price below the cost of production or the sale of goods abroad at a price which is lower than the selling price of the same goods at the same time in the same circumstances at home, taking account of difference in transport costs.

Types of Dumping:

Dumping is of three types, viz., intermittent dumping, persistent dumping and predatory dumping.

1. Intermittent Dumping:

When the production of a product is more than the demand in the home country, the stocks piled up even after sales. In such a case the producer sells the remaining stock in foreign countries at low price without reducing the price in domestic countries.

2. Persistent Dumping:

The monopolist sells the remaining production in foreign countries at a low price continuously. This type of dumping is called persistent dumping.

3. Predatory Dumping:

The monopolist sells the product in foreign market at a low price initially with a view to drive away the competitors and increase the price after the competitors leave the market. This type of dumping is called predatory dumping.

Objectives of Dumping:

The objectives of dumping include:

1. To enter the Foreign Market:

The monopolist adopt the dumping strategy to enter a foreign market by eliminating the competitors in the foreign market.

2. To sell surplus production:

The producers dump the products in the foreign countries in order to sell their surplus production.

3. To develop trade relations:

The manufacturers sell their output in foreign countries at low price in order to develop trade relations with the foreign countries.

Effects of Dumping:

Dumping affects both the importing and exporting countries. However, the effects are more on importing country.



Effects on Importing Country:

1. The industry of the importing country experiences the decline in sales and profits. For example, China dumped its steel in India and consequently Indian steel Industry faced the problems of decline in sales and the deflationary conditions.
2. If the dumping is for longer period, it affects the survival of the industry and also changes the industrial structure in the foreign country. If the dumping company increases the price at the later stage (i.e, after eliminating competition) the importing country would be at loss both in terms of high cost of imports and change in the structure of the domestic industry.
3. Dumping changes the preferences of the consumers of the domestic country. But, if the dumping is stopped after some time, the country is forced to import at high prices.
4. Dumping increases the deficit of the balance of payments of the importing country.
5. The importing country can benefit from dumping by imposing anti-dumping tariffs as Indian Government imposed tariffs on cooking oil dumped by USA and Malaysia.

Effects on Exporting Country:

1. The consumers of the exporting country pay higher price when the consumers of foreign country enjoy the product at lower price.
2. The exporting country finds market for the excess production.
3. The exporting country earns foreign exchange and it contributes for the surplus balance of the balance of payment of payments position.

1. Association of Southeast Asian Nations (ASEAN)

The Association of Southeast Asian Nations (ASEAN) was formed in 1967 by Indonesia, Malaysia, the Philippines, Singapore, and Thailand to promote political and economic cooperation and regional stability. The member countries of the Association of Southeast Asian Nations (ASEAN) are Indonesia, Malaysia, Philippines, Singapore, Thailand, Brunei Darussalam, Vietnam, Laos and Myanmar. The ASEAN Community is comprised

of three pillars, the Political-Security Community, Economic Community and Socio-Cultural Community. Every year following the ASEAN Ministerial Meeting, ASEAN holds its Post-Ministerial Conference (PMC) to which the Secretary of State is invited. In 1994, ASEAN took the lead in establishing the ASEAN Regional Forum (ARF), which now has 27 members.

1.1 Objectives:

The ASEAN nations came together with three main objectives in mind:

To promote the economic, social and cultural development of the region through cooperative programmers

To safeguard the political and economic stability of the region against big power rivalry; and

To serve as a forum for the resolution of intra-regional differences.

1.2 Activities:

ASEAN and its Member States reaffirm and adhere to the fundamental principles contained in the declarations, agreements, conventions, concords, treaties and other instruments of ASEAN. ASEAN and its Member States shall act in accordance with the following Principles:



Respect for the independence, sovereignty, equality, territorial integrity and national identity of all ASEAN Member States;

Shared commitment and collective responsibility in enhancing regional peace, security and prosperity;

Renunciation of aggression and of the threat or use of force or other actions in any manner inconsistent with international law;

Reliance on peaceful settlement of disputes;

Non-interference in the internal affairs of ASEAN Member States;

Respect for the right of every Member State to lead its national existence free from external interference, subversion and coercion;

Enhanced consultations on matters seriously affecting the common interest of ASEAN

Respect for fundamental freedoms, the promotion and protection of human rights, and the promotion of social justice;

Upholding the United Nations Charter and international law, including international humanitarian law, subscribed to by ASEAN Member States;

Abstention from participation in any policy or activity, including the use of its territory, pursued by any ASEAN Member State or non-ASEAN State or any non-State actor, which threatens the sovereignty, territorial integrity or political and economic stability of ASEAN Member States;

Respect for the different cultures, languages and religions of the peoples of ASEAN, while emphasizing their common values in the spirit of unity in diversity.

1.3 Contribution:

Cooperation in Industrial Development, Cooperation in Finance and Banking, Cooperation in Investment, Cooperation in Food, Agriculture and Forestry, Cooperation in Minerals, Cooperation in Energy, Cooperation in Transportation and Communications, Cooperation in Tourism, Cooperation in Services, Cooperation in Intellectual Property, Private Sector.

2. Asia Pacific Economic Co-operation (APEC)

The Asia Pacific Economic Cooperation (APEC) was established in 1989 as an informal Ministerial-level dialogue group with twelve members. Today APEC has 21 member economies spread out over four continents. APEC Member Economies work together to sustain economic growth through a commitment to open trade, investment and economic reform. This is accomplished by progressively reducing tariffs and other barriers to trade.

2.1 Objectives:

The current member economies represent the rich diversity of the region as well as differing levels of economic growth. Despite such differences there is a growing sense of common purpose and cooperation aimed at sustained regional and world growth. In the 1991 Seoul APEC Declaration, APEC members agreed on specific objectives:

To sustain the growth and development of the region for the common good of its peoples and, in this way, to contribute to the growth and development of the world economy;

To enhance the positive gains, both for the region and the world economy, resulting from increasing economic interdependence, to include encouraging the flow of goods, services, capital, and technology;

To develop and strengthen the open multilateral trading system in the interest of Asia-Pacific and all other economies; and

To reduce barriers to trade in goods and services among participants in a manner consistent with GATT principles, where applicable, and without detriment to other economies.

2.2 Activities:



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APEC aims to strengthen regional economic integration by removing impediments to trade and investment “at the border”, enhancing supply chain connectivity “across the border” and improving the business environment “behind the border”. It endeavors to improve the operating environment for business by reducing the cost of cross-border trade, improving access to trade information and simplifying regulatory and administrative processes. APEC also assists member economies build the institutional capacity to implement and take advantage of the benefits of trade and investment reform. APEC supports the multilateral trade negotiations underway in the WTO, and complements the goals of the G-20 Framework for Strong, Sustainable and Balanced Growth in the Asia-Pacific Region.

2.3 Contribution:

APEC is the premier Asia-Pacific economic forum. Their primary goal is to support sustainable economic growth and prosperity in the Asia-Pacific region.

They are united their drive to build a dynamic and harmonious Asia-Pacific community by championing free and open trade and investment, promoting and accelerating regional economic integration, encouraging economic and technical cooperation, enhancing human security, and facilitating a favorable and sustainable business environment. Our initiatives turn policy goals into concrete results and agreements into tangible benefits.

3. African Union (AU)

The advent of the African Union (AU) can be described as an event of great magnitude in the institutional evolution of the continent. On 9.9.1999, the Heads of State and Government of the Organization of African Unity issued a Declaration (the Sirte Declaration) calling for the establishment of an African Union, with a view, inter alia, to accelerating the process of integration in the continent to enable it play its rightful role in the global economy while addressing multifaceted social, economic and political problems compounded as they are by certain negative aspects of globalization.

3.1 Objectives:

The main objective of the Congress of African Economists is to provide a forum for African economists, from the continent and from the Diaspora, to come up with concrete solutions to integration and development challenges facing Africa. Specifically, the Congress aims at considering, discussing and analyzing contemporary development issues, and proposing appropriate and extensive solutions to the socio-economic problems. These will:

Provide a forum for African economists, from the continent and from the Diaspora, to weigh in on current development of the continent, and foster dialogue among African economists and policymakers;

Encourage and enhance research relating to integration and development of the continent;

Promote knowledge sharing as an important component of effective policy making; and

Provide clear recommendations to assist African countries in reformulating their economic policies with a view to addressing current socio-economic challenges.

To defend the sovereignty, territorial integrity and independence of its Member States;

To accelerate the political and socio-economic integration of the continent;

To promote and defend African common positions on issues of interest to the continent and its peoples;

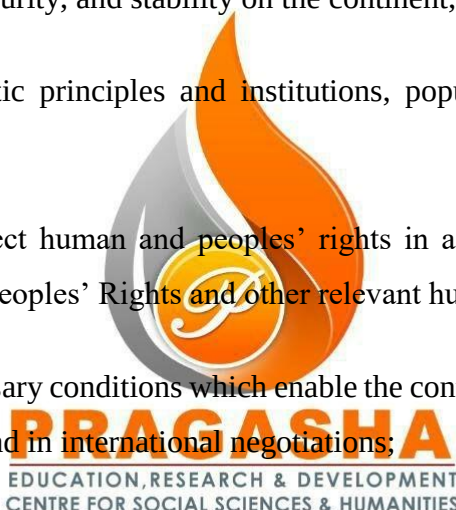
To encourage international cooperation, taking due account of the Charter of the United Nations and the Universal Declaration of Human Rights;

To promote peace, security, and stability on the continent;

To promote democratic principles and institutions, popular participation and good governance;

To promote and protect human and peoples' rights in accordance with the African Charter on Human and Peoples' Rights and other relevant human rights instruments;

To establish the necessary conditions which enable the continent to play its rightful role in the global economy and in international negotiations;



Elaboration and coordination of the implementation of strategies, and framework for policies and regulatory harmonization for the development of communication and Information Technology (CIT) in Africa: ICT, Telecommunications, Broadcasting and postal services

Promotion of the introduction and wide use of CIT applications and services in all socio development sectors of education health agriculture, economy and Government services.

Elaboration and facilitating implementation of an integrated continental CIT master plans for soft and hard infrastructure

Facilitation of implementation as well as monitoring and evaluation of projects and programs in the CIT sector and sub-sector

Coordination and cooperation with RECS, specialized agencies and other regional and all international partners in the field of CIT

Preparation of review reports on development of CIT in Africa

Development of sectorial data base and information system

Monitor and facilitate implementation of Policies, strategies, integration-driven Continental and regional infrastructure projects

Organization of workshops, seminars, meetings and conference involving member states and other stake holders on ICT issues

Contribute to the mobilization of resources for the development of ICT infrastructure and services

Advocate for African interests on ICT in the international arena

Preparation of working documents and organize the session of CITMC as well as the meetings of the bureau and steering committee of the conference , organize workshops seminars and meetings related to the sector

Production and/or review of the draft report to the executive council , the assembly of head of state government



3.2 Activities:

3.3 Contribution:

The evolution of the African Union as a successor organization to the Organization of African Unity in terms of its mandate for conflict prevention, peacekeeping, peacemaking and peace-building. The Union has established a continent-wide peace and security architecture through its Peace and Security Council. The regional economic communities are the building blocks of this architecture creating something like a ‘multi-layered security community’. They function synergistically by acting as conduits of policy implementation of the Union. Finally, it also identifies some of the hurdles ahead of the organization to realize a robust peace and security architecture on the continent.

4. Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC)

The Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) is an international organization involving a group of countries in South Asia and South East Asia. These are: Bangladesh, India, Myanmar, Sri Lanka, Thailand, Bhutan and Nepal. On 6 June 1997, a new sub-regional grouping was formed in Bangkok and given the name BIST-EC (Bangladesh, India, Sri Lanka, and Thailand Economic Cooperation). Myanmar attended the inaugural June Meeting as an observer and joined the organization as a full member at a Special Ministerial Meeting held in Bangkok on 22 December 1997, upon which the name of the grouping was changed to BIMST-EC. Nepal was granted observer status by the second Ministerial Meeting in Dhaka in December 1998. Subsequently, full membership has been granted to Nepal and Bhutan in 2003. In the first Summit on 31 July 2004, leaders of the group agreed that the name of the grouping should be known as BIMSTEC or the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation.

4.1 Objectives

To create, manage and evaluate energy related data-base relevant to the region; and taking into view various on-going activities and suggest a road map for meaningful intra-BIMSTEC cooperation.



To prepare and operationalise a framework for networking among the national level institutions in the region.

To prepare the groundwork, such as feasibility studies, data collection etc. for intra-BIMSTEC energy related projects.

To study, compile and disseminate the prevailing policies of the BIMSTEC member countries indifferent areas of energy sector.

To enhance cooperation for capacity building and sharing of experiences on best practices, including reforms, regulation and energy efficiency.

To function as the secretariat for energy cooperation activities.

4.2 Activities:

prepare and operationalise a framework for networking among the national level institutions in the region. Prepare the groundwork, such as feasibility studies, data collection etc. for intra- BIMSTEC energy related projects

4.3 Contribution:

BIMSTEC aims to strengthen regional economic integration by removing impediments to trade and investment. It endeavors to improve the operating environment for business by reducing the cost of cross-border trade, improving access to trade information and simplifying regulatory and administrative processes. BIMSTEC supports the multilateral trade negotiations underway in the WTO, and complements the goals for Strong, Sustainable and Balanced Growth in the South Asia and South East Asia.

5. European Union (EU)

The European Union was formally established when the Maastricht Treaty—whose main architects were Helmut Kohl and François Mitterrand—came into force on 1 November 1993. In 1995, Austria, Finland, and Sweden joined the EU. In 2002, euro banknotes and coins replaced national currencies in 12 of the member states. The European Union (EU) is an economic and political union of 28 member states that are located primarily in Europe. The EU operates through a system of supranational independent institutions and intergovernmental negotiated decisions by the member states

5.1 Objectives:

Promote social cohesion and equal opportunities for all through adequate, accessible, financially sustainable, adaptable and efficient social protection systems and social inclusion policies;

Interact closely with the Lisbon objectives for achieving greater economic growth and more and better jobs, as well as with the Union's Sustainable Development Strategy;

Improve governance, transparency and the involvement of stakeholders in the design, implementation and monitoring of policy.

5.2 Activities:

The European Union (EU) is unique. It is not a federal state like the United States of America because its member countries remain independent sovereign nations. Nor is it a purely intergovernmental organization like the United Nations because the member countries do pool some of their sovereignty — and thus gain much greater collective strength and influence than they could have acting individually. They pool their sovereignty by taking joint decisions through shared institutions such as the European Parliament, which is elected by the EU citizens, and the European Council and the Council, which both represents national governments. They decide on the basis of proposals from the European Commission, which represents the interests of the EU as a whole. It also gives a brief overview of the agencies and other bodies that are involved in the European Union's work.

5.3 Contribution:

Cooperation in Industrial Development, Cooperation in Finance and Banking, Cooperation in Investment, Cooperation in Food, Agriculture and Forestry, Cooperation in Minerals, Cooperation in Energy, Cooperation in Transportation and Communications, Cooperation in Tourism, Cooperation in Services, Cooperation in Intellectual Property, Private Sector.



6. North American Free Trade Agreement (NAFTA)

In January 1994, the United States, Mexico and Canada entered into the North American Free Trade Agreement (NAFTA), creating the largest free trade area and richest market in the world. The NAFTA is the most comprehensive regional trade agreement ever negotiated by the United States and is scheduled to be fully implemented by the year 2008. In 1996, U.S. two-way trade in goods under the NAFTA with Canada and Mexico stood at \$420 billion—a 44 % increase since the NAFTA was signed.

6.1 Objectives:

1. The objectives of this Agreement, as elaborated more specifically through its principles and rules, including national treatment, most-favored-nation treatment and transparency are to:

eliminate barriers to trade in, and facilitate the cross border movement of, goods and services between the territories of the Parties;

promote conditions of fair competition in the free trade area;

increase substantially investment opportunities in their territories;

provide adequate and effective protection and enforcement of intellectual property rights in each Party's territory;

create effective procedures for the implementation and application of this Agreement, and for its joint administration and the resolution of disputes; and

establish a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this Agreement.

2. The Parties shall interpret and apply the provisions of this Agreement in the light of its objectives set out in paragraph 1 and in accordance with applicable rules of international law.

6.2 Activities:

to reduce barriers to trade



to increase cooperation for improving working conditions in North America

to create an expanded and safe market for goods and services produced in North America

to establish clear and mutually advantageous trade rules

to help develop and expand world trade and provide a catalyst to broader international cooperation

6.3 Contribution:

The North American Free Trade Agreement (NAFTA) will not be fully implemented until 2008. However, it is evident that NAFTA has already proved its worth to the United States

by playing an important and vital role in increasing consumer choice, improving market access for U.S. products, and expanding U.S. jobs supported by exports. It also contribute in agricultural trade, automotive industry, and textile and apparel.

7. Organization of Petroleum Exporting Countries (OPEC)

Organization of Petroleum Exporting Countries (OPEC) was established on September 14, 1960, it consisted of just five developing countries. The founding members of the Organization of the Oil Exporting Countries are Iran, Iraq, Kuwait, Saudi Arabia and Venezuela. OPEC's six other members are Qatar (which joined in 1961), Indonesia (joined in 1962), Libya (joined in 1962), the United Arab Emirates (which took over the membership of Abu Dhabi in 1974), Algeria (joined in 1969) and Nigeria (joined in 1971).

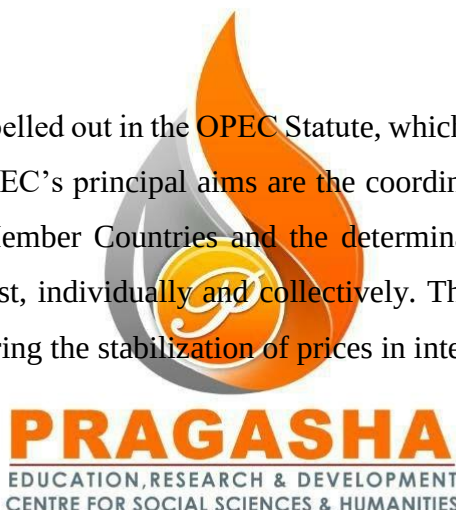
7.1 Objectives:

OPEC's objectives are spelled out in the OPEC Statute, which dates from the earliest days of the organization: "OPEC's principal aims are the coordination and unification of the petroleum policies of Member Countries and the determination of the best means for safeguarding their interest, individually and collectively. The Organization shall devise ways and means of ensuring the stabilization of prices in international oil markets,

7.2 Activities:

These documents were adopted in the 1960s, when the world oil industry, outside the former centrally planned economies, was dominated by the "The Seven Sisters" multinational oil companies. In such an environment, oil prices were at extremely low levels, with minimal returns for those countries within whose borders the crude reserves lay.

OPEC asserted its role in the 1970s, supporting its member countries as they took control of their domestic oil industries and acquired a major say in the pricing of oil on world markets. While the situation has moved on since then, with a broadening of the power base in a more integrated and consensual global industry, OPEC is nevertheless envisaged today as a major player in the world oil market.



There is one other important early document of relevance to OPEC's role — the “Solemn Declaration” adopted by a conference of OPEC sovereigns and heads of state in Algiers in 1975. This declaration carried a proposal for a “New International Economic Order” aimed at promoting a more equitable global economic system, with particular emphasis on alleviating poverty and other injustices affecting developing countries by encouraging greater interdependence among nations from the north and south.

The proposal for a new international economic order led to the establishment of the OPEC Fund for International Development, which is a multilateral development finance institution seeking to promote cooperation between OPEC members and other developing countries. Over the years, the OPEC Fund has distributed loans and grants to 104 countries located in Africa, Asia, Latin America, the Caribbean and Europe. Including grants and contributions to other institutions, the Fund's total approved commitments, as of the end of September 1999, stood at \$5.4 billion (U.S.), with disbursements reaching \$3.7 billion.

7.3 Contribution:

The “Organization of Petroleum Exporting Countries” (OPEC) includes most of the world's major oil-exporting countries. By agreeing to limit their respective production levels, they maintain a higher price for their oil worldwide. While this extends the life of their domestic fields, and provides substantial income, it is a semi-monopoly that limits the affordability of petroleum in many of the world's developing countries. There is no international law that prohibits such cartels, as would apply within many countries. (In the past, such attempts to control the worldwide production of raw materials would have almost certainly led to conquest of these areas by militarily stronger countries.)

8. South Asian Association for Regional Cooperation (SAARC)

The South Asian Association for Regional Cooperation (SAARC) comprises Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka. SAARC is a manifestation of the determination of the peoples of South Asia to work together towards finding solutions to their common problems in a spirit of friendship, trust and understanding and to create an order based on mutual respect, equity and shared benefits. The main goal of the Association is to accelerate the process of economic and social development in member states, through joint action in the agreed areas of cooperation. The idea of

regional cooperation in South Asia was first mooted in November 1980. After consultations, the Foreign Secretaries of the seven countries met for the first time in Colombo, in April 1981. This was followed, a few months later, by the meeting of the Committee of the Whole, which identified five broad areas for regional cooperation. The Foreign Ministers, at their first meeting in New Delhi, in August 1983, formally launched the Integrated Programme of Action (IPA) through the adoption of the Declaration on South Asian Regional Cooperation (SARC). At the First Summit held in Dhaka on 7-8 December 1985, the Charter establishing the South Asian Association for Regional Cooperation (SAARC) was adopted.

8.1 Objectives:

The objectives are as follows:

To promote the welfare of the peoples of South Asia and to improve their quality of life;

To accelerate economic growth, social progress and cultural development in the region and to provide all individuals the opportunity to live in dignity and to realize their full potentials;

To promote and strengthen collective self-reliance among the countries of South Asia;

To contribute to mutual trust, understanding and appreciation of one another's problems;

To promote active collaboration and mutual assistance in the economic, social, cultural, technical and scientific fields;

To strengthen cooperation with other developing countries;

To strengthen cooperation among themselves in international forums on matters of common interests; and

To cooperate with international and regional organizations with similar aims and purposes



Cooperation within the framework of the Association is based on respect for the principles of sovereign equality, territorial integrity, political independence, non-interference in the internal affairs of other states and mutual benefit.

Such cooperation is to complement and not to substitute bilateral or multilateral cooperation.

Such cooperation should be consistent with bilateral and multilateral obligations of the member states.

Decisions at all levels in SAARC are taken on the basis of unanimity.

Bilateral and contentious issues are excluded from its deliberations.

8.2 Activities:

8.3 Contribution:

Cooperation with international and regional organizations designated SAARC years, SAARC Regional Fund (SRF), SAARC funds, regional conventions/agreements), SAARC regional institutions, Promoting people-to-people contact, Trade and economic cooperation, poverty eradication, Technical committee, financial arrangements in SAARC.



9. World Bank (WB)

The World Bank is institutions in the United Nations system. They share the goal of raising living standards in their member countries. The World Bank concentrating on long-term economic development and poverty reduction. The World Bank was created at an international conference convened in Bretton Woods, New Hampshire, United States in July 1944. The goal of the conference was to establish a framework for economic cooperation and development that would lead to a more stable and prosperous global economy.

9.1 Objectives:

The World Bank was established to promote long-term foreign investment loans on reasonable terms. The, purposes of the Bank, as set forth in the ‘Articles of Agreement’ are as follows:

(i) To assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purpose including;

The restoration of economies destroyed or disrupted by war;

The reconversion of productive facilities to peaceful needs; and

The encouragement of the development of productive facilities and resources in less developing countries;

(ii) To promote private investment by means of guarantee or participation in loans and other investments made by private investors.

(iii) When private capital is not available on reasonable terms, to supplement private investment by providing on suitable conditions finance for productive purpose out of its own capital funds raised by it and its other resources.

(iv) To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living, and conditions of labour in their territories.

(v) To arrange the loans made or guaranteed by it in relation to international loans through other channels so that the more useful and urgent projects, large and small alike, will be dealt with first.

(vi) To conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and in the immediate postwar years, to assist in bringing about a smooth transition from a wartime to peacetime economy.

9.2 Activities:

Granting reconstruction loans to war devastated countries.

Granting developmental loans to underdeveloped countries.

Providing loans to governments for agriculture, irrigation, power, transport, water supply, educations, health, etc

Providing loans to private concerns for specified projects.

Promoting foreign investment by guaranteeing loans provided by other organizations.

Providing technical, economic and monetary advice to member countries for specific projects

Encouraging industrial development of underdeveloped countries by promoting economic reforms.

9.3 Contribution:

The World Bank promotes long-term economic development and poverty reduction by providing technical and financial support to help countries reform particular sectors or implement specific projects—for example, building schools and health centers, providing water and electricity, fighting disease, and protecting the environment. World Bank assistance is generally long-term and is funded both by member country contributions and through bond issuance. World Bank staffs are often specialists in particular issues, sectors, or techniques.



10. International Monetary Fund (IMF)

The International Monetary Fund was created at an international conference convened in Bretton Woods, New Hampshire, United States in July 1944. The goal of the conference was to establish a framework for economic cooperation and development that would lead to a more stable and prosperous global economy. The International Monetary Fund (IMF) is an organization of 188 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.

10.1 Objectives:

IMF seeks to achieve the following objectives:

- To promote international monetary cooperation.
- To facilitate the expansion of international trade.
- To ensure stability to foreign exchange rates.
- To reduce disequilibrium in the international balance of payments of member countries.
- To promote capital investment in backward and underdevelopment countries.
- To assist in the establishment of a multinational system of payments in respect of current transactions between the member countries.
- To secure multilateral convertibility (i.e., to convert the currency of any member into the currency of any other member).
- To provide short term monetary help to members during emergency.
- To achieve balanced economic growth and high level of employment in member countries.

10.2 Activities:

IMF performs the following functions.



Providing short terms credit to member countries for meeting temporary difficulties due to adverse balance of payments.

Reconciling conflicting claims of member countries.

Providing a reservoir of currencies of member-countries and enabling members to borrow on another's currency.

Promoting orderly adjustment of exchange rates.

Advising member countries on economic, monetary and technical matters.

10.3 Contribution:

The IMF has shown great interest in the economic development of under development countries. It has made a steady progress towards the establishment of a multilateral system of payment in respect of current transactions. The IMF promotes international monetary cooperation and provides policy advice and technical assistance to help countries build and maintain strong economies. The Fund also makes loans and helps countries design policy programs to solve balance of payments problems when sufficient financing on affordable terms cannot be obtained to meet net international payments. IMF loans are short and medium term and funded mainly by the pool of quota contributions that its members provide. IMF staffs are primarily economists with wide experience in macroeconomic and financial policies.

11. World trade Organization (WTO)

The World Trade Organization (WTO) is the only global international organization dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments. The goal is to help producers of goods and services, exporters, and importers conduct their business. 159 members on 2 March 2013.

11.1 Objectives:

The purposes of objectives of the WTO are spelled out in the preamble to Marrakesh Agreement. In a nutshell, these are:

- To ensure the reduction of tariffs and other barriers to trade.
- To eliminate discriminatory treatment in international trade relations.
- To facilitate higher standards of living, full employment, a growing volume of real income and effective demand and an increase in production and trade in good and services of the member nations.
- To make positive effect, which insures developing countries especially the least developed secure level of share in the growth of international trade that reflects the needs of their economic development?
- To facilitates the optimal use of the world's resources for sustainable development.
- To promote an integrated, more visible and durable trading system incorporating all the resolutions of the Uruguay Round's Multi literal trade negotiations.

The WTO provides the forum for negotiations among its members concerning their multilateral trade relations in matters dealt with under the agreements and a framework for the implementation of the results of such negotiations, as may be decided by the Ministerial Conference.

The WTO administers the Understandings on Rules and Procedures governing the Settlement of Disputes.

The WTO administers the Trade Policy Review Mechanism (TPRM).

With a view to achieving greater coherence in global economic policy-making, the WTO cooperates as appropriate, with the International Monetary Fund (IMF) and with the International Bank for Reconstruction and Development (World Bank) and its affiliate agencies.

The WTO facilitates the implementation, administration and operation, and furthers the objectives, of this Agreement and the Multilateral Trade Agreements, and also provide framework for the implementation, administration and operation of the Plurilateral Trade Agreements.

11.2 Activities:

11.3 Contribution:



Succeeded in reducing some barriers to international trade.

12. Food and Agricultural Organization (FAO)

The Food and Agriculture Organization (FAO) of the United Nations leads international efforts to defeat hunger. Serving both developed and developing countries, FAO acts as a neutral forum where all nations meet as equals to negotiate agreements and debate policy. FAO is also a source of knowledge and information. The organization helps developing countries and countries in transition modernize and improve agriculture, forestry and fisheries practices and ensure good nutrition for all. The FAO was founded in 1945; since then, focus has been placed on developing rural areas, which are home to 70 percent of the world's poor and hungry people.

12.1 Objectives:

The main objectives of the FAO are:

Putting information within reach

Sharing policy expertise

Providing a meeting place for nations

Bringing knowledge to the field

12.2 Activities:

The Food and Agricultural Organization or FAO is part of the United Nations. It's mission is to defeat world hunger. It is a forum for nations to discuss policy in a neutral environment. It provides information regarding agriculture, fisheries and forests in terms of improving and maintaining sustainability in each of these important parts of the ecosystem. FAO's activities comprise four main areas: Putting information within reach, Sharing policy expertise, providing a meeting place for nations, providing a meeting place for nations. Bringing knowledge to the field.

12.3 Contribution:



Food security and sustainable agriculture have been improved in Asia and the Pacific region as a result of several contributory factors: attention to issues affecting rural poverty and the development of human resources, support for agricultural research and extension, and the development and adoption of appropriate technology for agricultural development. The experience and expertise of FAO in topics ranging from the broad socio-economic to the very specialized and technical issues relating to the agricultural sector, together with FAO's close and extensive knowledge of the local, national and regional situations, have had a visible impact in the member countries. Within the mandate of the Field Programme, FAO has implemented a number of projects, as described below, in support of sustainable agriculture and the development of the forestry and fisheries sectors. Table 3 shows the support given during the period 1970-1990, for some selected countries for which data were available.

Unit – 11: Accounting and Finance

- ✓ **Accounting Standards in India**, Inflation Accounting, Human Resource Accounting, Responsibility Accounting, Social Accounting
- ✓ Money and Capital Market, Working of Stock Exchange in India, NSE, OTCEI, NASDAQ, Derivatives and Options
- ✓ Regulatory Authorities: SEBI, Rating Agencies, New Instruments: GDRs, ADRs
- ✓ Venture Capital Funds, Merger and Acquisitions, Mutual Funds, Lease Financing, Factoring, Measurement of Risk and Return, Securities and Portfolios
- ✓ Computer Application in Accounting and Finance

Notes

Accounting

Basic Accounting Concepts

The basic accounting concepts are referred to as the fundamental ideas or basic assumptions underlying the theory and practice of financial accounting and are broad working rules for all accounting activities and developed by the accounting profession. The important concepts have been listed as below:

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1. **Business Entity** : This concept assumes that business has distinct and separate entity from its owners. Thus, for the purpose of accounting, business and its owners are to be treated as two separate entities.
 2. **Money Measurement** : The concept of money measurement states that only those transactions and happenings in an organisation, which can be expressed in terms of money are to be recorded in the book of accounts. Also, the records of the transactions are to be kept not in the physical units but in the monetary units.
 3. **Going Concern** : The concept of going concern assumes that a business firm would continue to carry out its operations indefinitely (for a fairly long period of time) and would not be liquidated in the near future.
 4. **Accounting Period** : Accounting period refers to the span of time at the end of which the financial statements of an enterprise are prepared to know

whether it has earned profits or incurred losses during that period and what exactly is the position of its assets and liabilities, at the end of that period.

5. **Cost Concept** : The cost concept requires that all assets are recorded in the book of accounts at their cost price, which includes cost of acquisition, transportation, installation and making the asset ready for the use.
6. **Dual Aspect** : This concept states that every transaction has a dual or two-fold effect on various accounts and should therefore be recorded at two places. The duality principle is commonly expressed in terms of fundamental accounting equation, which is : $\text{Assets} = \text{Liabilities} + \text{Capital}$
7. **Revenue Recognition** : Revenue is the gross in-flow of cash arising from the sale of goods and services by an enterprise and use by others of the enterprise resources yielding interest royalties and dividends. The concept of revenue recognition requires that the revenue for a business transaction should be considered realised when a legal right to receive it arises.
8. **Matching** : The concept of matching emphasises that expenses incurred in an accounting period should be matched with revenues during that period. It follows from this that the revenue and expenses incurred to earn these revenue must belong to the same accounting period.
9. **Full Disclosure** : This concept requires that all material and relevant facts concerning financial performance of an enterprise must be fully and completely disclosed in the financial statements and their accompanying footnotes.
10. **Consistency** : This concept states that accounting policies and practices followed by enterprises should be uniform and consistent one the period of time so that results are composable. Comparability results when the same accounting principles are consistently being applied by different enterprises for the period under comparison, or the same firm for a number of periods.
11. **Conservatism** : This concept requires that business transactions should be recorded in such a manner that profits are not overstated. All anticipated losses should be accounted for but all unrealised gains should be ignored.
12. **Materiality** : This concept states that accounting should focus on material facts. If the item is likely to influence the decision of a reasonably prudent

investor or creditor, it should be regarded as material, and shown in the financial statements.

13. Objectivity : According to this concept, accounting transactions should be recorded in the manner so that it is free from the bias of accountants and others.

Accounting Standards in India

Accounting Standards (AS 1~32) of ICAI

Accounting Standards: Accounting standards are written statements of uniform accounting rules and guidelines in practice for preparing the uniform and consistent financial statements. These standards cannot override the provisions of applicable laws, customs, usages and business environment in the country.

The Accounting Standards (i.e. AS 1~32) have been issued/ amended by “Accounting Standards Board” of the ICAI from time to time, to establish uniform standards for preparation of financial statements, in accordance with generally accepted accounting practices in India (i.e. Indian GAAP) and for better understanding of the users.



Generally Accepted Accounting principles (GAAP) refer to the rules or guidelines adopted for recording and reporting of business transactions in order to bring uniformity in the preparation and presentation of financial statements. These principles are also referred to as concepts and conventions. From the practicality view point, the various terms such as principles, postulates, conventions modifying principles, assumptions, etc. have been used interchangeably and are referred to as basic accounting concepts.

These standards are mandatory on the dates specified either in the respective document or by notification issued by the Council of the ICAI.

List of ICAI's Mandatory Accounting Standards (AS 1~29)

Accounting Standards of ICAI (as on 1 July 2017 and onwards), as under:

AS 1 Disclosure of Accounting Policies

AS 2 Valuation of Inventories (amended) *

AS 3 Cash Flow Statements

AS 4 Contingencies and Events Occurring after the Balance Sheet Date (amended)

*

AS 5 Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies

AS 6 Depreciation Accounting (withdrawn) *

AS 7 Construction Contracts (revised 2002)

AS 8 Accounting for Research and Development (withdrawn for AS 26)

AS 9 Revenue Recognition

AS 10 Accounting for Fixed Assets (amended) *

AS 11 The Effects of Changes in Foreign Exchange Rates (revised 2003) ** / ***

AS 12 Accounting for Government Grants

AS 13 Accounting for Investments (amended) *

AS 14 Accounting for Amalgamations (amended) *

AS 15 Employee Benefits (revised 2005)

AS 16 Borrowing Costs

AS 17 Segment Reporting

AS 18 Related Party Disclosures



AS 19 Leases

AS 20 Earnings Per Share

AS 21 Consolidated Financial Statements (amended) *

AS 22 Accounting for Taxes on Income

AS 23 Accounting for Investments in Associates in Consolidated Financial Statements

AS 24 Discontinuing Operations

AS 25 Interim Financial Reporting

AS 26 Intangible Assets

AS 27 Financial Reporting of Interests in Joint Ventures

AS 28 Impairment of Assets

AS 29 Provisions, Contingent Liabilities and Contingent Assets (amended) *



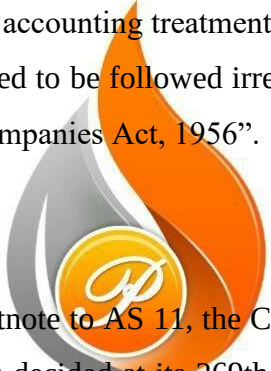
* ICAI Amends AS 2, AS 4, AS 10, AS 13, AS 14, AS 21, AS 29 and withdraws AS 6

** Withdrawal of Announcement on AS-11 by ICAI

The Council of the ICAI had issued an Announcement on 'Treatment of exchange differences under Accounting Standard (AS) 11 (revised 2003), The Effects of Changes in Foreign Exchange Rates vis-à-vis Schedule VI to the Companies Act, 1956', which was published in the November 2003 issue of 'The Chartered Accountant'.

Subsequent to the issuance of the above Announcement, the Ministry of Company Affairs (now known as the Ministry of Corporate Affairs) issued the Companies (Accounting Standards) Rules, 2006, by way of Notification in the Official Gazette dated 7th December, 2006. As per Rule 3(2) of the said Rules, the Accounting Standards shall come into effect in respect of accounting periods commencing on or after the publication of these accounting standards under the said Notification.

AS 11, as published in the above Government Notification, carries a footnote that “it may be noted that the accounting treatment of exchange differences contained in this Standard is required to be followed irrespective of the relevant provisions of Schedule VI to the Companies Act, 1956”.



In view of the above footnote to AS 11, the Council of the Institute of Chartered Accountants of India has decided at its 269th meeting held on July 18, 2007, to withdraw the Announcement on ‘Treatment of exchange differences under Accounting Standard (AS) 11 (revised 2003). The Effects of Changes in Foreign Exchange Rates vis-à-vis Schedule VI to the Companies Act, 1956’, published in ‘The Chartered Accountant’ of November 2003. Accordingly, the accounting treatment of exchange differences contained in AS 11 notified as above is applicable and not the requirements of Schedule VI to the Act, in respect of accounting periods commencing on or after 7th December, 2006.

Withdrawal Announcement by ICAI on ‘Treatment of exchange differences under AS 11

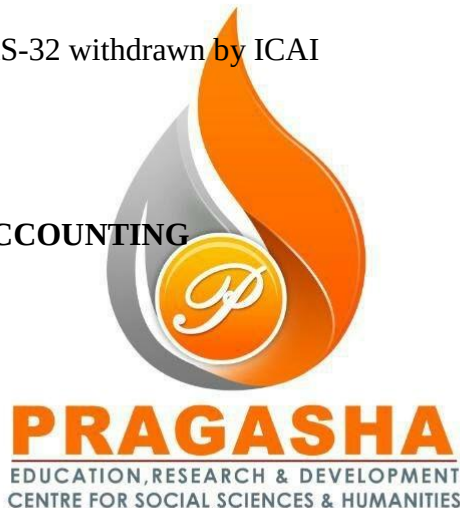
*** Companies (Accounting Standards) Amendment Rules, 2018 notified by MCA: AS 11 amended

List of ICAI's Non-Mandatory Accounting Standards (AS 30~32)

ICAI has announced on 15 Nov. 2016 that 'AS 30- Financial Instruments: Recognition and Measurement', 'AS 31- Financial Instruments: Presentation', 'AS 32- Financial Instruments: Disclosures' stands withdrawn. For details, please refer the link below:

AS-30, AS-31, AS-32 withdrawn by ICAI

INFLATION ACCOUNTING



Unit – 12: Income Tax Law and Tax Planning

- ✓ Basic Concepts, Residential Status and Tax Incidence, Exempted Incomes, Computation of Taxable Income under Various Heads
- ✓ Computation of Taxable Income of Individuals and Firms
- ✓ Deduction of Tax, Filing of Returns, Different Types of Assessment, Defaults and Penalties
- ✓ Tax Planning: Concept, Significance and Problems of Tax Planning, Tax Evasion and Tax Avoidance, Methods of Tax Planning
- ✓ Tax Consideration in Specific Business Decision viz., make or buy; own or lease; retain or replace; Export or Domestic Sales; Shut-down or Closure; Expand or Contract; Invest or Disinvest
- ✓ Computer Application in Income Tax and Tax Planning

Income Tax Law and Tax Planning

Introduction

Before one can embark on a study of the law of income-tax, it is absolutely vital to understand some of the expressions found under the Income-tax Act, 1961. The purpose of this Chapter is to enable the students to comprehend basic expressions. Therefore, all such basic terms are explained and suitable illustrations are provided to define their meaning and scope.

IMPORTANCE

The Taxation Structure of the country can play a very important role in the working of our economy. Some time back the emphasis was on higher rates of Tax and more incentives. But recently, the emphasis has shifted to Decrease in rates of taxes and withdrawal of incentives. While designing the Taxation structure it has to be seen that it is in conformity with our economic and social objectives. It should not impair the incentives to personal savings and investment flow and on the other hand it should not result into decrease in revenue for the State.

In our present day economy structure Income Tax plays a vital role as a source of Revenue and a measure of removal economic disparity. Our Taxation structure provides for Two types of Taxes --- DIRECT and INDIRECT ; Income Tax , Wealth Tax and Gift Tax are Direct Taxes whereas Sales Tax and Excise Duties are Indirect Taxes.

HISTORY

The Income Tax was introduced in India for the first time in 1860 by British rulers following the mutiny of 1857. The period between 1860 and 1886 was a period of experiments in the context of Income Tax. This period ended in 1886 when first Income Tax Act came into existence. The pattern laid down in it for levying of Tax continues to operate even to-day though in some changed form. In 1918, another Act- Income Tax Act, 1918 was passed but it was short lived and was replaced by Income Tax Act, 1922 and it remained in existence and operation till 31st. March, 1961.

PRESENT ACT

On the recommendation of Law Commission & Direct Taxes Enquiry Committee and in consultation with Law Ministry a Bill was framed. This Bill was referred to a select committee and finally passed in Sept. 1961. This Act came into force from 1st. April 1962 in whole of the country. Income Tax Act, 1961 is a comprehensive Act and consists of 298 Sections. Sub-Sections running into thousands Schedules, Rules, Sub-Rules, etc. and is supported by other Acts and Rules. This Act has been amended by several amending Acts since 1961. The Annual Finance Bills presented to Parliament along with Budget make far-reaching amendments in this Act every year.

DIRECT AND INDIRECT TAXATION

DIRECT TAXATION

Meaning of Tax

Tax is a compulsory contribution to state revenue by the Government. It is levied on the income or profits from business of individuals and institutions. It may be added to the price of goods, services or transactions. Tax is the basic source of revenue to the

Government. This revenue is utilised for the expenses of civil administration, internal and external security, building infrastructure, etc.

Types of Taxes

There are two types of taxes – direct taxes and indirect taxes.

- I. **Direct Tax:** If a tax levied on the income or wealth of a person and is paid by that person (or his office) directly to the Government, it is called direct tax e.g. Income-Tax, Wealth Tax, Capital Gains Tax, Securities Transaction Tax, Fringe Benefits Tax (from 2005), Banking Cash Transaction Tax (for Rs.50,000 and above- from 2005), etc. In India all direct taxes are levied and administered by Central Board of Direct Taxes.
 - II. **Indirect Tax:** If tax is levied on the goods or services of a person (seller). It is collected from the buyers and is paid by seller to the Government. It is called indirect tax. e.g. GST.
- 32.02 Income Tax** Income tax is a direct tax under which tax is calculated on the income, gains or profits earned by a person such as individuals and other artificial entities (a partnership firm, company, etc.)

Features of Income Tax in India

- i. **Levied as Per the Constitution:** Income tax is levied in India by virtue of entry No. 82 of list I (Union List) of Seventh Schedule to the Article 246 of the Constitution of India.
- ii. **Levied by Central Government:** Income tax is charged by the Central Government on all incomes other than agricultural income. However, the power to charge income tax on agricultural income has been vested with the State Government as per entry 46 of list II, i.e., State List.
- iii. **Direct Tax:** Income tax is direct tax. It is because the liability to deposit and ultimate burden are on same person. The person earning income is liable to pay income tax out of his own pocket and cannot pass on the burden of tax to another person.
- iv. **Annual Tax:** Income tax is an annual tax because it is the income of a particular year which is chargeable to tax.
- v. **Tax on Person:** It is a tax on income earned by a person. The term 'person' has been defined under the Income tax Act. It includes individual, Hindu Undivided Family,

Firm, Company, local authority, Association of person or body of Individual or any other artificial juridical persons. The persons who are covered under Income tax Act are called 'assesseees'.

- vi. **Tax on Income:** It is a tax on income. The Income tax Act has defined the term income and it includes salary income, house property income, business/profession income, capital gains and other sources income. However, there are certain incomes which are specifically exempt from income tax.
- vii. **Income of 'Previous Year' is Assessable in 'Assessment Year':** Income earned during a particular financial year is assessed to tax in the immediately following financial year. The year of earning income is called 'Previous Year' and the year in which assessment of income is done is called 'Assessment Year'. The income tax return of previous year's income is filed in the relevant assessment year.
- viii. **Charged at Prescribed Rate(s):** Income tax is charged at prescribed rate(s). The rates of income tax differ for different income and for different persons. While tax rates for normal incomes are prescribed by the annual Finance Act, tax rates for certain special incomes have been prescribed under Income Tax Act itself. For instance, the following tax rates have been prescribed under Income Tax Act.
 - a. Tax on long term capital gain @ 20% (Section 112).
 - b. Tax on short term capital gain on shares covered under STT @15% (Section 111A).
 - c. Tax on lottery income @ 30% (Section 115BB)
- ix. **Administered by the Central Government:** Income tax is administered by the Central Government (Ministry of Finance) with the help of 'Income tax department' with branches throughout the country. The Central Government has constituted the 'Central Board of Direct Taxes' (CBDT) which exercises overall control over the Income tax department by issuing guidelines for related matters.
- x. **Applicability:** Income Tax is applicable throughout India including the State of Jammu and Kashmir.

Basic Concepts of Income Tax

- i. **Assessee [(Sec. 2(7))]:** Assessee means a person by whom any tax or any other sum of money is payable under this Act. It includes every person in respect of whom any

proceeding has been taken for the assessment of his income or assessment of fringe benefits.

ii. Person [Sec.2 (31)]: The term ‘person’ includes the following

- (i) an individual,
- (ii) a Hindu Undivided Family (HUF),
- (iii) a company,
- (iv) a firm,
- (v) an Association Of Persons or a Body Of Individual, whether incorporated or not,
- (vi) a local authority, and
- (vii) every artificial juridical person e.g., an idol or deity.

iii. Assessment Year (A.Y) [Sec.2 (9)]: The term has been defined under section 2(9). The year in which tax is paid is called the assessment year. It normally consisting of a period of 12 months commencing on 1st April every year and ending on 31st March of the following year.

iv. Previous Year (P.Y) [Sec. (3)]: The year in which income is earned is called previous year. It is also normally consisting of a period of 12 months commencing on 1st April every year and ending on 31st March of the following year. It is also called as financial year immediately following the assessment year.



v. Income [Sec.2 (24)]: Income includes the followings;

- (i) Profits and gains of business or profession.
- (ii) Dividend
- (iii) Voluntary contribution received by a charitable / religious trust or university/education institution or hospital/electoral trust [w.e.f.01.04.2010]
- (iv) Value of perquisite or profit in lieu of salary taxable u/s 17 and social allowance or benefit specifically granted either to meet personal expenses or for performance of duties of an office or an employment of profit.
- (v) Export incentives, like duty drawback, cash compensatory support, sale of licenses, etc.,

- (vi) Interest, salary, bonus, commission or remuneration earned by a partner of a firm from such firm.
- (vii) Capital gain chargeable u/s 45.
- (viii) Profits and gains from the business of banking carried on by a co- operative society with its members.
- (ix) Winning from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever.
- (x) Deemed income u/s 41 or 59.
- (xi) Sums received by an assessee from his employees towards welfare fund contribution such as provident fund, superannuation fund, etc.
- (xii) Amount received under key man insurance policy including bonus thereon.
- (xiii) Amount received under agreement for-(a) not carrying out activity in relation to any business, or (b) not sharing any know – how, patent, copyright etc.
- (xiv) Benefit or perquisite received from a company, by a director or a person holding substantial interest or a relative of the director or such person.
- (xv) Gift as defined u/s 56 (2)(vi), and others.

vi. Agricultural Income (Section 2(1A)) Any rent or revenue derived from land which is situated in India and is used for agriculture purposes. Agricultural income is fully exempted from tax u/s 10(1) and as such does not form part of total income.

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Heads of Income [Sec. 14]

Section 14 of Income Tax Act 1961 provides for the computation of total income of an assessee which is divided under five heads of income. Each head of income has its own method of computation. These five heads are;

- (i) Income from ‘Salaries’ [Sections 15-17];
- (ii) Income from ‘House Property’[Sections 22-27];
- (iii) Income from ‘Profits and Gains of Business or Profession’ [Sections 28-44];
- (iv) Income from ‘Capital Gains’ [Sections 45-55]; and
- (v) Income from ‘Other Sources’ [Sections 56-59].

Gross Total Income (GTI) [Section 80B (5)]: Income from all the above five heads of income shall be computed separately according to the provisions given in the Act. Income computed under these heads shall be aggregated after adjusting past and present losses and the total so arrived at is known as ‘Gross Total Income’.

(i) Income from ‘Salaries’	*****
(ii) Income from ‘House Property’	*****
(iii) Income from ‘Business or Profession’	*****
(iv) Income from ‘Capital Gains’	*****
(v) Income from ‘Other Sources’	*****
Gross Total Income (GTI)	*****

Total Income (T.I.) [Sections 2 (45)]: Out of Gross Total Income, Income tax Act 1961 allows certain deductions under section 80. After allowing these deductions the figure which we arrive at is called ‘Total Income’ and on this figure tax liability is computed at the prescribed rates.

Gross Total Income	*****
Less: Deductions (Sec. 80C to 80U)	*****

Total Income (T.I.) *****

80C Deductions; Contribution to Provident Fund, life Insurance Premium, Children’s Tuition Fees, Health Insurance Premium, Investment in National Savings Certificate, interest paid for home loans, etc.

Income Tax Slab Rate for Individual -Illustration As per the Assessment Year 2018-19

TOTAL INCOME(Rs)	Income Tax Rate
Upto 2,50,000	Nil

2,50,001 – 500,000	5%
500,001 – 10,00,000	20%
Above 10,00,000	30%

Residential Status for Income Tax – Individuals & Residents

It is important for Income Tax Department to determine the residential status of a tax paying individual or company. It becomes particularly relevant during the tax filing season. In fact, this is one of the factors based on which a person's taxability is decided. Let us explore the residential status and taxability in detail.

1. Meaning and importance of residential status

The taxability of an individual in India depends upon his residential status in India for any particular financial year. The term residential status has been coined under the income tax laws of India and must not be confused with an individual's citizenship in India. An individual may be a citizen of India but may end up being a non-resident for a particular year. Similarly, a foreign citizen may end up being a resident of India for income tax purposes for a particular year.



Also to note that the residential status of different types of persons viz an individual, a firm, a company etc is determined differently. In this article, we have discussed about how the residential status of an individual taxpayer can be determined for any particular financial year

2. How to determine residential status?

For the purpose of income tax in India, the income tax laws in India classifies taxable persons as:

- a. A resident**
- b. A resident not ordinarily resident (RNOR)**

c. A non-resident (NR)

The taxability differs for each of the above categories of taxpayers. Before we get into taxability, let us first understand how a taxpayer becomes a resident, an RNOR or an NR.

Resident need help with?

A taxpayer would qualify as a resident of India if he satisfies one of the following 2 conditions:

1. Stay in India for a year is 182 days or more or
2. Stay in India for the immediately 4 preceding years is 365 days or more **and** 60 days or more in the relevant financial year

In the event an individual leaves India for employment during an FY, he will qualify as a resident of India only if he stays in India for 182 days or more. This otherwise means, condition (b) above of 60 days would not apply to him

Resident Not Ordinarily Resident

If an individual qualifies as a resident, the next step is to determine if he/she is a Resident ordinarily resident (ROR) or an RNOR. He will be a ROR if he meets both of the following conditions:

1. Has been a resident of India in at least 2 out of 10 years immediately previous years and
2. Has stayed in India for at least 730 days in 7 immediately preceding years

Therefore, if any individual fails to satisfy even one of the above conditions, he would be an RNOR.

Non-resident

An individual satisfying neither of the conditions stated in (a) or (b) above would be an NR for the year.



3. Taxability

Resident: A resident will be charged to tax in India on his global income i.e. income earned in India as well as income earned outside India.

NR and RNOR: Their tax liability in India is restricted to the income they earn in India. They need not pay any tax in India on their foreign income.

Also note that in a case of double taxation of income where the same income is getting taxed in India as well as abroad, one may resort to the Double Taxation Avoidance Agreement (DTAA) that India would have entered into with the other country in order to eliminate the possibility of paying taxes twice.

What is Income Tax? How to calculate the tax I am liable to pay?

Income Tax is a tax on your income that is imposed by the Government of India. Government needs revenues for maintaining infrastructure, providing social welfare services and for meeting the expenses of defence and internal security. Before you get into the calculation of tax, first understand who has to file tax returns. That is where the discussion begins.

Who is required to file Income Tax returns?



It is essential to file tax returns under the following conditions...

- If your gross total income (before allowing any deductions under section 80C to 80U) exceeds Rs. 2,50,000 then you are required to file IT returns. This limit is Rs. 3 lakh for senior citizens and Rs. 5 lakh for super-senior citizens (above the age of 80).
- If the assessee is a company or a firm irrespective of whether it has made a profit or a loss during the financial year, it needs to file returns.
- If you want to claim tax refund, it is essential to file tax returns. Also if you want to carry forward a loss under a head of income filing of returns is required.
- If you have exempt capital gains above Rs. 2.50 lakh even if no tax is payable under Section 54EC or similar exemptions you need to file returns.

- Return filing is mandatory if you are a Resident Indian and have an asset or financial interest in an entity located outside of India. This is not applicable if you are an NRI.
- In the absence of all these conditions, you still have to file returns if you want to submit the document as proof of income for loan applications or visa applications.

Understanding Financial Year and Assessment Years

When it comes to filing returns, there are two important concepts that have to be understood i.e. Assessment Year and Financial Year. The financial year is also popularly known as Previous Year. For example, the income that you earn between April 01, 2017, and March 31, 2018, will be your previous year (financial year) 2017-18 for the purpose of tax payment. This will correspond to the assessment year 2018-19. The return for the financial year 2017-18 will have to be filed by you before July 31, 2018.

How much tax do I have to pay?

Having understood the concept of financial year and assessment, the next question is how much tax has to be paid? There are different rates for different categories but the largest number of taxpayers is in the under-60 category males. The following are the tax rates for this category of males under the age of 60.

Applicable Tax Rates for the financial year 2017-18 (AY 2018-19)

Income Slab	Applicable tax rate
Up to Rs. 2,50,000 per annum	No tax
Rs. 2,50,001 - Rs. 5,00,000	5%
Rs. 5,00,001 - Rs. 10,00,000	20%
Above Rs. 10,00,000	30%

The above rates are the flat rates of tax. In addition, all tax payers will be subject to an education cess of 2% and secondary and higher education cess of 1%. (The cess now stands combined to a flat rate of 4% from Financial Year 2018-19 onwards). If your net taxable income is more than Rs50 lakh for the year then there is a surcharge of 10% payable on your tax and if your annual taxable income is more than Rs100 lakh, i.e. Rs1cr,

then the surcharge applicable is 15%. For the higher income groups, the cess will be calculated on the total of tax and surcharge.

How do the calculations work out for the three income groups?

Particulars	Taxable income Rs. 18 lakh	Taxable income Rs. 60 lakh	Taxable income Rs. 1.1cr
Net Taxable Income	Rs. 18,00,000	Rs. 60,00,000	Rs. 1,10,00,000
Assessment Year	2018-19	2018-19	2018-19
Tax Calculation			
First Rs. 2.50 lakh	Nil	Nil	Nil
Rs. 2.50 lakh - Rs. 5 lakh	Rs. 12,500	Rs. 12,500	Rs. 12,500
Rs. 5 lakh - Rs. 10 lakh	Rs. 1,00,000	Rs. 1,00,000	Rs. 1,00,000
Above Rs. 10 lakh	Rs. 2,40,000	Rs. 15,00,000	Rs. 30,00,000
Income Tax	Rs. 3,52,500	Rs. 16,12,500	Rs. 31,12,500
Surcharge on Income Tax (0% / 10% / 15%)	N.A.	Rs. 1,61,250	Rs. 4,66,875
Education Cess (2%)	Rs. 7,050	Rs. 35,475	Rs. 71,588
Secondary Education Cess (1%)	Rs. 3,525	Rs. 17,738	Rs. 35,794
Total Tax Payable	Rs. 3,63,075	Rs. 18,26,963	Rs. 36,86,757
Effective Tax Rate (%)	20.17%	30.45%	33.52%

In taxation parlance, this is called progressive taxation, which means as your income level goes up, your effective tax rate also goes higher.

Arriving at the taxable income

We have seen the calculation of the tax based on different levels of taxable income. But the big question is how did we arrive at the taxable income in the first place? You start with your total income earned and then take all the exemptions along the way before

arriving at your net taxable income. These are the steps based on which the calculation of taxable income is worked out.

- Firstly, the salary income is considered as the starting point. Effective from the financial year 2018-19, the total income will be net of Rs. 40,000 standard deductions.
- Once the salary income is calculated, the other sources of income like capital gains and other income are computed.
- The calculation of income from house property is slightly more complicated. If you have one self-occupied property, then you can claim the interest paid on home loan up to Rs. 2 lakh per annum. This can be shown as loss on house property and adjusted against your total income.
- When the above heads of income are added up, you have the total income. From the total income so calculated, deductions under Section 80C, Section 80D, Section 80E and others are deducted within their prescribed limits. The balance is the total taxable income. It is on this taxable income that the tax payable is calculated.

Key changes to Income Tax rules from FY2018-19

The Union Budget 2018 made some key changes to the calculation of income tax on your total income. While the tax rates and the slabs were left untouched, the following changes were made which will have an impact on calculation of total income tax.

- The Union Budget reintroduced the Standard Deduction at the flat rate of Rs. 40,000 per annum. Apart from the salary earners, pensioners will also be able to claim the standard deduction. This can be claimed flat without submitting any bills.
- In lieu of the introduction of standard deduction, the budget has done away with the exemption for transport allowance and medical reimbursement. Currently, medical allowance up to Rs. 15,000 per month and transport allowance up to Rs. 19,200 per month can be claimed as tax-free against bills produced. Now both these allowances will be taxable.

- The education cess of 2% and the higher education cess of 1% has been now combined into a single “Health and Education Cess” at an enhanced rate of 4%. This will be charged on the tax payable.
- Long term capital gains (LTCG) on equities and equity mutual funds re-introduced in this budget at a flat rate of 10% without the benefit of indexation. This 10% tax will be levied on annual capital gains above Rs. 1 lakh.
- For senior citizens, the limit for exempt interest income has been raised from Rs. 10,000 to Rs. 50,000 per annum. Also, no TDS will be deducted from interest payment up to Rs. 50,000 per annum.

Planning your tax for FY19? Here are some pointers to consider

While planning your taxes for the fiscal year (FY) 2018-19, it is essential to first understand the key changes in the Union Budget 2018. The Budget 2018 brought about some far-reaching changes that could make a significant difference to the tax liability of individuals. Some of the important announcements included the introduction of capital gains tax on equities, introduction of dividend distribution tax (DDT) on equity funds, reintroduction of standard deduction, tweaking the rates of tax, and some additional sops for senior citizens.

Let us look at some of the key changes from this Budget that are applicable for FY2018-19 as these will have a bearing on your tax liability as well as your tax planning methodology.

Tax rates maintained at same slabs

In the Union Budget 2017, the slab rates of tax at the lowest taxable rate of Rs. 2.5 lakh to Rs. 5 lakh were reduced from 10% to 5%. That classification has been maintained in the Assessment Year (AY) 2019-20 also. It needs to be remembered that the distinction of male assessee and female assessee does not exist any longer. There are only special rates of tax for senior citizens (above 60) and for super senior citizens (above 80).

For others, the slab rates for income tax are as under:

Income Slab	Tax Rate (Assessee below 60)

Up to Rs. 2,50,000	Nil
Rs. 2,50,001 - Rs. 5,00,000	5% of income in excess of Rs. 2.50 lakh
Rs. 5,00,001 - Rs. 10,00,000	20% of income in excess of Rs. 5 lakh
Above Rs. 10,00,000	30% of income in excess of Rs. 10 lakh

Senior citizens are required to pay tax at slightly lower rates compared to assessee below the age of 60.

The rates of tax for senior citizens are as under:

Income Slab	Tax Rate
Up to Rs. 3,00,000	Nil
Rs. 3,00,001 - Rs. 5,00,000	5% of income in excess of Rs. 3.00 lakh
Rs. 5,00,001 - Rs. 10,00,000	20% of income in excess of Rs. 5 lakh
Above Rs. 10,00,000	30% of income in excess of Rs. 10 lakh

For super senior citizens, these tax slabs have been further compressed into just three slabs as under:

Income Slab	Tax Rate
Up to Rs. 5,00,000	Nil
Rs. 5,00,001 - Rs. 10,00,000	20% of income in excess of Rs. 5 lakhs
Above Rs. 10,00,000	30% of income in excess of Rs. 10 lakh

In addition to the above basic rates of tax, the following additional charges will be payable as levy to the Government of India for FY2018-19 corresponding to AY2019-20.

- An additional surcharge of 10% will be levied in case income exceeds Rs. 50 lakh in a financial year.
- If the income in a financial year exceeds Rs. 1cr, then the surcharge is hiked to 15% from 10%.

- In addition to the surcharge (which is only applicable above Rs. 50 lakh) there is a Health and Education Cess of 4% which is payable by all assesseees irrespective of the level of income.

Let us look at the impact of surcharge and the Health and Education Cess on different levels of taxable income for FY2018-19 (AY2019-20)

Particulars	Middle Income Bracket	Higher Income Bracket	Super-Higher Income Bracket
Taxable Income	Rs. 38,00,000	Rs. 65,00,000	Rs. 1,15,00,000
Surcharge Applicable	Nil	10%	15%
Income Tax on Slab	Rs. 9,52,500	Rs. 17,62,500	Rs. 32,62,500
Surcharge	N.A.	Rs. 1,76,250	Rs. 4,89,375
Health and Education Cess (4%)	Rs. 38,100	Rs. 77,550	Rs. 1,50,075
Total Tax Liability	Rs. 9,90,600	Rs. 20,16,300	Rs. 39,01,950

The above illustration shows how the basic tax rate, surcharge, and the Health & Education Cess add up to determine your eventual tax liability. There is an important point we need to remember about the Health and Education Cess effective FY2018-19.

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Till the previous year, there was an education cess of 2% and an additional higher education cess of 1%. In the financial year 2018-19, these two cesses have been merged into a single cess called the Health and Education Cess and are chargeable at 4%. Effectively, the rate of cess has increased in FY2018-19 from a combined rate of 3% to a consolidated rate of 4%. One also needs to remember that the cess is charged on the total sum of (tax + surcharge). Thus, the impact of the cess on higher income groups is effectively much higher.

Hike in Education Cess in FY 2018-19

This has been discussed in the income tax slab calculation but let us understand this in greater detail. A cess is imposed in addition to the tax and is a levy on the tax. So a cess of 5% essential means that it is imposed at 5% on the tax amount. The total tax liability is

the basic liability plus the cess payable. Additionally, the cess is imposed on the sum total of the tax payable and the surcharge, so the impact is much higher on high income groups.

Let us see how three income groups were impacted by the cess in the last two assessment years.

Particulars	Mid Income FY17-18	Mid Income FY18-19	High Income FY17-18	High Income FY18-19	HNI Income FY17-18	HNI Income FY18-19
Taxable Income	Rs. 32 lak	Rs. 32 lak	Rs. 70 lakh	Rs. 70 lakh	Rs. 1.25cr	Rs. 1.25cr
Base Tax Payab	Rs. 7,72,500	Rs. 7,72,500	Rs. 19,12,500	Rs. 19,12,500	Rs. 35,62,500	Rs. 35,62,500
Tax Surcharge	N.A.	N.A.	Rs. 1,91,25	Rs. 1,91,25	Rs. 5,34,37	Rs. 5,34,37
Education ce (2%)	Rs. 15,450	N.A.	Rs. 42,075	N.A.	Rs. 81,938	N.A.
Higher Edu Ce (1%)	Rs. 7,725	N.A.	Rs. 21,038	N.A.	Rs. 40,969	N.A.
Health & E Cess (4%)	N.A.	Rs. 30,900	N.A.	Rs. 84,150	N.A.	Rs. 1,63,87
Total Tax Payab	Rs. 7,95,675	Rs. 8,03,400	Rs. 21,66,863	Rs. 21,87,900	Rs. 42,19,782	Rs. 42,60,750
Effective T Rate	24.86%	25.11%	30.96%	31.26%	33.76%	34.09%

As can be seen from the above table, the increase in the effective tax rate is a result of the increase in the cess from 3% to 4% over the last one year.

There is an important point to remember pertaining to the filing of returns. Each year, the returns have to be filed by July 31 (for 2018, the last date has been extended to August 31). That means for the income pertaining to the financial year 2017-18, corresponding to the AY2019-20, the last date for filing returns shall be August 31, 2018.

Now, under Section 234F of the Income Tax Act, a compulsory penalty will be charged if the returns are filed after the said date. Such penalty will have to be paid in advance before filing the said returns.

Sr.No.	Year	Period to file delayed return (after due date)	Period to file revised return (after due date)	Can delayed return be revised?
1.	Till financial year 2015-16	Can be filed till two years from the end of the financial year.	Can be filed till two years from the end of the financial year.	No, a delayed return cannot be revised.
2.	For financial year 2016-17	Can be filed till one year from the end of the financial year.	Can be filed till two years from the end of the financial year.	YES , a delayed return can be revised till one year from the end of financial year.
3.	From financial year 2017-18	Can be filed till one year from the end of the financial year.	Can be filed till one year from the end of the financial year.	YES , a delayed return can be revised till one year from the end of financial year.

Standard deduction on income from salaries and pensions



A standard deduction of Rs. 40,000/- in lieu of transport and reimbursement of miscellaneous medical expenses will be allowed effective FY2018-19 corresponding to the AY2019-20. A unique feature of this mandatory deduction is that apart from salary earners, this facility will also be available to pensioners as they do not get any such benefits.

However, there are a few things one needs to understand from a tax-planning perspective. For example, the standard deduction is in lieu of medical allowance and transport allowance. Currently, salaried individuals are eligible for tax exemption up to Rs. 19,200 pa on transport allowance and Rs. 15,000 pa on medical allowance.

Look at the incremental benefit for an individual salaried employee in the table below.

Details	AY2018-19	AY2019-20
Gross Salary	Rs. 650,000	Rs. 650,000
Transport Allowance (Rs. 1,200 p month is exempt)	Rs. 19,200	N.A.
Medical Allowance	Rs. 15,000	N.A.
Standard Deduction	N.A.	Rs. 40,000
Net salary post deductions	Rs. 6,15,800	Rs. 6,10,000
Impact of shift to Standard Deduction		Net salary reduces by Rs. 5,800 due standard deduction

The tax saving is much smaller in the case of salaried individuals as they are losing out on the medical allowance and the transport allowance. However, in the case of pensioners, who do not receive transport and medical allowance, this standard deduction of Rs. 40,000 comes as a major boon. And this does not, in any way, impact their medical reimbursements and hospitalization coverage under government schemes.

But does it really benefit in the overall scheme of things? When you compare the impact of standard deduction in two years, you must consider the combined effect of the loss of medical allowance and transport allowance plus the higher cess of 4% that you pay.

This is how the combined impact works out.

Tax Calculation on Salary	AY2018-19	AY2019-20
Gross Pension Received	Rs. 28,25,000	Rs. 28,25,000
Transport Allowance (Rs. 1,200 per month is exempt)	Rs. 19,200	N.A.
Medical Allowance	Rs. 15,000	N.A.
Standard Deduction	N.A.	Rs. 40,000
Net salary post deductions	Rs. 27,90,800	Rs. 27,85,000
Income Tax Calculations		
Income Tax	Rs. 6,49,740	Rs. 6,48,000
Surcharge	0	0

Education Cess (2% of tax payable)	Rs. 12,995	N.A.
Secondary and Higher Education Cess (@1% of tax payable)	Rs. 6,497	N.A.
Education and Health Cess (combined rate of 4% of tax payable)	--	Rs. 25,920
Total Tax Liability	Rs. 6,69,232	Rs. 6,73,920
Additional tax paid under the New Standard Deduction formula	--	Rs. 4,688

So the net outcome is that when you consider the combined effect, you actually end up paying higher taxes in the post standard deduction scenario.

Higher deduction for medical insurance premium for senior citizens (Section 80D)

Currently, Section 80D permits separate deductions for your family and for your parents. The deductions are much higher if your dependent parents are senior citizens above the age of 60.

The amount of deduction available to senior citizens for payment of mediclaim premium is increased as follows:



Existing deduction limit From FY 2018-19 (AY 2019-20)

Deduction allowed for senior citizens and very senior citizens

Rs. 30,000/-

Rs. 50,000/-

Effectively, the deduction for senior citizens has been raised from Rs. 30,000 pa to Rs. 50,000 pa in terms of contribution to medical insurance premium paid to IRDA-approved health insurance schemes.

In the best scenario, if you are aged 61 and your father is aged 85, then you can claim a total medical insurance premium rebate of Rs. 100,000 (Rs. 50,000 for your family and Rs. 50,000 for your parents) and that will take your effective tax shield on medical premium to approximately 30% of the tax contribution. Considering the rising medical costs, you can make the best of this benefit.

Deduction for expenditure incurred on medical treatment, etc. (Section 80DD)

Currently, the Section 80DD pertains to the expenditure on medical treatment for senior citizens. It was available in slabs for senior citizens and for super senior citizens, but has been since merged into a single higher limit as under:

Existing deduction limit	From FY2018-19 (AY2019-20)
Deduction allowed for:	
Senior Citizens: Rs. 60,000/-	Senior Citizen and Very Senior Citizen: Rs. 1,00,000
Very Senior Citizen: Rs. 80,000/-	

Deduction in respect of interest on deposits in savings accounts for senior citizens

This was one area of major discomfort for senior citizens. Many senior citizens depend on interest from investments to meet their household expenses. However, the limit of exemption on this interest income at Rs.10,000 was too low for the full year. Additionally, this facility was only available for savings bank accounts and not for fixed deposits (FDs) and recurring deposits (RDs).

The Union Budget 2018 made some special changes for the sake of senior citizens and super senior citizens as under:



Particulars	Existing deduction limit	From FY2018-19 (AY2019-20)
Deduction allowed for senior citizens and very senior citizens:		
Interest from savings bank account / post office	Rs. 10,000/-	Rs. 50,000/-
Interest from FDs and RDs	Nil	

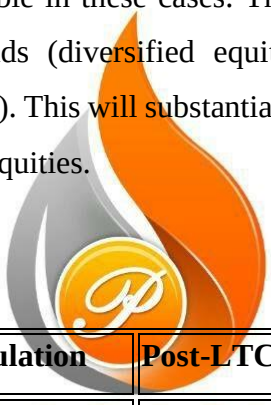
This higher exemption is only available for senior citizens and very senior citizens. For regular tax payers under the age of 60, the old exemption limit of Rs. 10,000 pa will be applicable. Senior citizens can now avail tax-free interest to the extent of Rs. 50,000 pa. However, this is not the biggest benefit for them. Under Section 194A, no TDS will be

deducted on the amount of such interest earned by senior citizens and very senior citizens up to Rs. 50,000. Currently, TDS is deducted and senior citizens are either required to submit Form 15G in advance or have to claim a refund from the Income Tax department. More than the tax liability, it was the process that was cumbersome; this has now been resolved.

Changes in taxation on long-term capital gains (LTCG) on equities

Long-term capital gains on equities and equity funds were hitherto tax-free until FY2017-18. However, effective April 2018, all long-term capital gains (LTCG) on equities are taxable at a flat rate of 10%. There is a basic exemption of Rs1 lakh and any gains above this limit in a the given assessment year will be taxable at 10%. This means that the benefit of indexation will not be available in these cases. The LTCG tax will be applicable to equity investments, equity funds (diversified equity funds, balanced equity funds, arbitrage funds, index funds, etc.). This will substantially change the economics of capital gains calculation in the case of equities.

Consider the table below:



Pre-LTCG Tax	Calculation	Post-LTCG Tax	Calculation
Retirement SIP monthly	Rs. 10,000	Retirement SIP monthly	Rs. 10,000
Tenure of SIP	25 years	Tenure of SIP	25 years
Invested in	Equity Funds	Invested in	Equity Funds
CAGR returns	14%	CAGR returns	14%
Amount Contributed	Rs. 30,00,000	Amount Contributed	Rs. 30,00,000
Final Corpus	Rs. 2,72,72,777	Final Corpus	Rs. 2,72,72,777
Long-Term Capital Gain	Rs. 2,42,72,777	Long-Term Capital Gain	Rs. 2,42,72,777
Basic Exemption	N.A.	Basic Exemption	Rs. 1,00,000
Taxable LTCG	N.A.	Taxable LTCG	Rs. 2,41,72,777
Tax on LTCG (Nil)	N.A.	Tax on LTCG (10%)	Rs. 24,17,278
Net Corpus on hand	Rs. 2,72,72,777	Net Corpus on hand	Rs. 2,48,55,499

As can be seen from the above table, the LTCG tax is making a significant difference to your post-tax wealth, especially when you are indulging in long-range SIPs over a long period. In such cases, the capital gains component is quite high, and hence, investors will have to either increase their monthly SIP contribution by 10% or they will have to be mentally prepared for lower corpus retention in post-tax terms.

There are some finer points that investors need to be aware of in this case. The gains earned up to January 31, 2018, are exempt. Let's us understand this with an example.

Equity shares of a company were purchased on July 01, 2017, at Rs. 100 per share and were sold on September 01, 2018, for Rs. 130 per share. This results in a long-term capital gain of Rs. 30 per share. Now, suppose the highest share price on January 31, 2018, was Rs. 120 per share. Then, the taxable LTCG will be Rs. 10, i.e. $\text{Rs. } 130 - \text{Rs. } 120 = \text{Rs. } 10$ as the price on January 31 will be considered as the cut-off for calculating your capital gains taxation.

However, any sales done and profits booked before March 31, 2018, are entirely exempt from LTCG tax.

Another point to be noted here is that unit-linked insurance plans (ULIPs) will not attract any tax since they are not classified as equity. However, it is not certain if it will lead to a shift in the preference for ULIPs. It is also not certain if the government may think of reclassifying ULIPs to fall under the purview of LTCG.

NPS exemption for the self-employed

This pertains to the contribution to the National Pension Scheme (NPS) where there is an additional exemption up to Rs. 50,000 pa (over and above the extant limit of Rs. 1.50 lakh available under Section 80C of the IT Act) for specific contributions like PPF, CPF, Life Insurance, long-term deposits, ELSS, tuition fees, principal on home loan, etc. This Union has been taken one step further in the Union Budget 2018.

So far, only salaried employees were allowed to withdraw up to 40% of their total accumulated corpus from the National Pension Scheme (NPS) at maturity or account closure without any tax implications. This facility has now been extended to non-salaried/self-employed persons too so as to give them a level playing field.

Lock-in period for Section 54EC bonds extended from three years to five years

Section 54EC is exclusively applicable to capital gains from property and land only and not to capital gains on other asset classes. Profits from the sale of real estate become tax-free if they are invested within six month in specified bonds under Section 54EC. The Union Budget has extended the lock-in period of investments in capital gain tax exemption bonds from three years to five years. This means that earlier you had to stay invested in the 54EC bonds for three years to get the tax break, but from now on your money will have to be locked in for five years to claim the exemption.

Now DDT imposed on equity funds too

Till now, the dividend distribution tax (DDT) was only applicable on debt funds and equity funds did not attract DDT. But effective Union Budget 2018, there will be a DDT of 10% on dividends distributed by an equity fund under its dividend plans. The effective DDT will be 11.648% (10% DDT + 12% surcharge + 4% Health & Education cess). The idea of imposing the DDT on equity funds is to put them at par with the capital gains tax of 10%.

DDT, which was applicable only to debt funds so far, will now apply to equity mutual funds as well. While dividends will remain tax-free in the hands of the investor, the fund house will have to pay 10% tax on income distributed to investors. Effectively, it will reduce the quantum of dividends in the hands of the investor. For example, if the equity fund declares a dividend of Rs. 10, then the investor will get only Rs. 8.8352 after deduction of DDT. While the investor does not directly pay this tax of his pocket, it still reduces the total dividend available to the investor.

This might be a good time for those who rely on dividends from equity funds as a form of income to review their investment strategy, since this tax will reduce the on-hand returns for investors if they choose the dividend option.

Key takeaways for planning your tax for FY2018-19

One of the basic rules of tax planning is to start early and be systematic. Don't try to cluster your tax planning in the last minute as it can put a lot of pressure on investors to arrange liquidity.

Therefore, remember these six points while planning taxes for FY2018-19:

- The impact of the Standard deduction of Rs. 40,000 is not likely to be significant on the overall tax liability. That is because the standard deduction comes in lieu of medical allowance and transport allowance. At higher income levels, the actual tax will be higher due to the impact of higher surcharge at 4% in FY2018-19.
- Investors must be cautious about using the dividend option in equity funds due to the DDT of 10%, which is an additional cost and reduces your dividend income. As part of smart tax planning, investors can look at structuring their withdrawals in the form systematic withdrawal plans (SWPs) to reduce the impact of dividends tax.
- The 10% LTCG tax on equities and equity funds does not make a case for ULIPs over ELSS. For tax planning, it is always better to keep your insurance and your investment products separate from one another. That also gels into the idea of financial planning using discrete products.
- The LTCG tax on equity funds may appear to be too high if you consider 10% on the capital gains without the benefit of indexation. One needs to look at it in terms of the impact on the compounded annual growth rate (CAGR). Over longer periods of 15-20 years, the impact on the CAGR returns as a result of the LTCG tax is less than 50 basis points. Hence, long-term financial plans are unlikely to be overly impacted by the LTCG tax.
- Make the best of the Section 80D benefits in the form of health cover for your family and your parents. At the peak level, the exemption can go as high as Rs1 lakh for medical insurance alone. This is a must with the rising cost of medical care and hospitalization. Moreover, this additional tax benefit also brings down your effective post-tax cost drastically.
- The government has made it quite clear that defaults in filing returns will be dealt with sternly. Effective FY2018-19, there will be a penalty of Rs5,000 for delayed filing of returns and that will have to be paid before the delayed returns can be filed.

Standard Deduction: Rs.40,000

Standard Deduction is a flat amount that was cut from the salary/income of an individual until it was abolished in FY2006. Before we get into the nuances of the new standard

deduction norms introduced in the Union Budget 2018, it would be prudent to understand how the original standard deduction worked.

How was the old standard deduction calculated?

The old model of standard deduction as a flat deduction from the total income had the following features:

- For salaried employees earning between Rs. 75,000 per annum (pa) and Rs. 5 lakh pa, the standard deduction was fixed at Rs. 30,000 pa or 40% of the income, whichever was lower.
- For salaried employees earning more than Rs. 5 lakh pa, the standard deduction was fixed at a flat Rs. 20,000 pa.
- This standard deduction was only for salaried employees. Hence, people earning pensions, interest income, or business income, could not avail this facility.
- The standard deduction was given to compensate salaried employees for recurring expenses. For example, self-employed professionals are allowed deductions for routine expenses. The idea of standard deduction was to put the salaried employees at par with self-employed professionals in terms of tax benefits.
- The advantage of standard deduction was that it was an extremely simple and flat deduction from the total salary income. No details like bills of expenses or invoices were required to avail it and all salaried employees were entitled to this deduction automatically.

Why was standard deduction abolished in Budget 2005?

In the Union Budget 2005, then Finance Minister P Chidambaram had announced the summary abolition of the standard deduction benefit to salaried employees. His argument was that since the standard deduction was in the nature of an allowance, it was naturally taxable and hence, there was no merit in continuing the scheme. With this, the standard deduction stood abolished from 2005 onwards.

Highlights of the 2018 announcement on standard deduction

In the Union Budget 2018, Arun Jaitley reintroduced the standard deduction at a flat rate of Rs. 40,000 pa.

The following are the key highlights of the new standard deduction announcement:

- The new standard deduction of Rs. 40,000 will be available to all salaried employees irrespective of the income levels. The would continue to remain at a flat rate.
- This new standard deduction will be in lieu of the exemptions that were earlier offered on medical allowance and transport allowance. Currently, transport allowance up to Rs. 19,200 pa and medical allowance up to Rs. 15,000 pa are permitted as reimbursement against actual production of bills. The medical allowance and the transport allowance benefit will stand abolished with effect from FY19.
- Pensioners who were not entitled to the standard deduction in the old methodology (until 2005) have also been included under the ambit of the new standard deduction. Moreover, pensioners will be the real beneficiaries of the standard deduction as they anyways do not get transport allowance and medical allowance. Hence, the entire benefit of Rs. 40,000 will be available to them.
- For salaried employees, the standard deduction of Rs. 40,000 will effectively replace the transport allowance of Rs. 19,200 and the medical allowance of Rs. 15,000 pa. Therefore, the effective benefit to a salaried individual will be to the extent of Rs. 5,800 pa in terms of exemption ($40,000 - 15,000 - 19,200 = 5800$).

Actual benefit of standard deduction to salaried employees and pensioners

The illustration below captures the impact that this shift will have on the net taxable salary income of the individual assessee on a salary income.

Details	AY2018-19	AY2019-20
Gross Salary	Rs. 650,000	Rs. 650,000
Transport Allowance (Rs. 1,200/month is exempt)	Rs. 19,200	Not Applicable
Medical Allowance	Rs. 15,000	Not Applicable
Standard Deduction	Not Applicable	Rs. 40,000

Net Salary post deductions	Rs. 615,800	Rs. 610,000
Impact of shift to Standard Deduction	--	Net salary reduces by Rs. 5,800 due to standard deduction

The benefit in the above case may not appear to be too attractive when the net impact is considered after adjusting for the forsaken benefits of transport allowance and medical allowance. However, the benefit could be more pronounced in case of pensioners. Check out the illustration below:

Details	AY2018-19	AY2019-20
Gross Pension Income	Rs. 520,000	Rs. 520,000
Transport Allowance (Rs. 1,200/month is exempt)	Not Applicable	Not Applicable
Medical Allowance	Not Applicable	Not Applicable
Standard Deduction	Not Applicable	Rs. 40,000
Net Income post deductions	Rs. 520,000	Rs. 480,000
Impact of shift to Standard Deduction	--	Net income reduces by Rs. 40,000 as result of standard deduction

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Thus, it can be observed from the above illustrations that the benefit of standard deduction is much higher in case of pensioners than it is for salaried employees. Nonetheless, the new system is more convenient as claiming standard deduction does not require an employee to produce bills and, consequently, is administratively simpler.

Understanding the impact of standard deduction shift on actual tax payable

One should keep in mind that the introduction of standard deduction has been accompanied with some other changes to the calculation of tax on salary. For example, medical allowance and transport allowance have been scrapped in lieu of standard deduction. On the other hand, the Education Cess has been increased from 3% to 4% in the Union Budget 2018.

What would be the overall impact of all these changes? Let us compare the actual tax calculations between AY2018-19 and AY2019-20.

Tax Calculation on Salary	AY2018-19	AY2019-20
Gross Income	Rs. 2,825,000	Rs. 2,825,000
Transport Allowance (Rs. 1,200/month is exempt)	Rs. 19,200	Not Applicable
Medical Allowance	Rs. 15,000	Not Applicable
Standard Deduction	Not Applicable	Rs. 40,000
Net Income post deductions	Rs. 27,90,800	Rs. 27,85,000
Income Tax Calculations		
Income Tax	Rs. 6,49,740	Rs. 6,48,000
Surcharge	0	0
Education Cess (@2% of tax payable)	Rs. 12,995	Not Applicable
Secondary and Higher Education Cess (@ 1% of tax payable)	Rs. 6,497	Not Applicable
Education and Health Cess (Combined rate of 4% of tax payable)	Not Applicable	Rs. 25,920
Total Tax Liability	Rs. 6,69,232	Rs. 6,73,920
Additional tax paid under the New Standard Deduction formula		Rs. 4,688

In a nutshell, there are two key things that we need to understand about the new standard deduction in the overall picture of your tax calculation.

- The full benefit of Rs. 40,000 standard deductions is only available to pensioners. In the case of salaried employees, this standard deduction comes in lieu of transport allowance (Rs. 19,200) and medical allowance (Rs. 15,000). Thus, the net benefit for the salaried employees is only Rs. 5,800.
- The cess on tax has been increased from 3% to 4%. In AY2018-19, there is an education cess of 2% and a higher secondary cess of 1% taking the total cess to 3%. However, in AY2019-20, the cess is combined into an 'Education and Health Cess' charged at 4% of the tax payable.

In the above illustration, the tax liability of the individual goes up despite the standard deduction as he has to pay a higher surcharge in AY2019-20. This explains the increase in tax liability for that year.

Exemptions under Section 10 of the Income Tax Act

Section 10 of the Income Tax Act specifies certain specific allowances or exemptions, as they are referred to, on income for taxpayers. All incomes other than those explicitly mentioned in this section are taxable in the hands of the recipient.

There are two such lists that are issued under the Income Tax Act and modified from time to time.

Firstly, there is the list in which incomes and allowances are fully exempt in the hands of the assessee, i.e. no tax is payable on such income. However, in most cases, you are still required to disclose the details of the exempted income in your annual tax returns.

Secondly, there is a list in which some expenses are partially tax exempt. Any source of income that is not mentioned in these two lists is, by definition, fully taxable in the hands of the assessee.

All incomes that do not figure in these lists of fully exempt or partially exempt income are, by default, fully taxable in the hands of the recipient.

To simplify things, we have divided this chapter into three modules:

- **Module 1:** It deals with the comprehensive list of all exemptions under Section 10 of the Income Tax Act.
- **Module 2:** It explains, in detail, the selected heads of income relevant to investors that are fully exempt from tax in the hands of the recipient.
- **Module 3:** It explains, in detail, the selected heads of income relevant to investors that are partially exempt from tax in the hands of the recipient

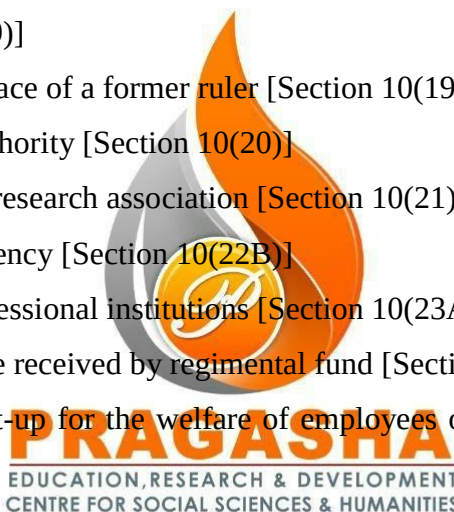
Let us first look at the comprehensive list of incomes that are exempt under section 10 of the Income Tax Act (this is a consolidated list of fully and partially exempt incomes).

Module 1: Income Exempt Under Section 10 of the Income Tax Act

Under the Income Tax Act, there is a list of 89 specified heads of income that are either fully or partially exempt from tax. They have been enumerated as under:

1. Agriculture income [Section 10(1)]
2. Any sum received by a coparcener from Hindu Undivided Family (HUF) [Section 10(2)]
3. Share of income from the firm [Section 10(2A)]
4. Interest paid to non-resident [Section 10(4)(i)]
5. Interest to non-resident on non-resident (external) account [Section 10(4)(ii)]
6. Interest paid to a person of Indian origin (PIO) who is non-resident [Section 10(4 B)]
7. Travel concession to an Indian citizen employee [Section 10(5)]
8. Remuneration received by an individual who is not a citizen of India [Section 10(6)]
9. Tax paid by the government or Indian concern on income of a foreign company [Section 10(6A), (6B), (6BB) and (6C)]
10. Perquisites and allowances paid by the government to its employees serving outside India [Section 10(7)]
11. Employees of foreign countries working in India under cooperative technical assistance programme [Section 10(8)]
12. Income of a consultant [Section 10(8A)]
13. Income of employees of consultant [Section 10(8B)]
14. Income of any member of the family of individuals working in India under co-operative technical assistance programmes [Section 10(9)]
15. Gratuity [Section 10(10)]
16. Commuted value of pension received [Section 10(10A)]
17. Amount received as leave encashment on retirement [Section 10(10AA)]
18. Retrenchment compensation paid to workmen [Section 10(10B)]
19. Payment received under Bhopal Gas Leak Disaster (Processing of Claims) Act, 1985 [Section 10 (10BB)]/ compensation received in case of any disaster [Section 10(10BC)]
20. Retirement compensation from a public sector company or any other company [Section 10 (10C)]
21. Income by way of tax on perks [Section 10(10CC)]
22. Any sum received under a life insurance policy [Section 10(10D)]
23. Payment from statutory provident fund [Section 10(11)]

24. Payment from recognised fund [Section 10(12)]
25. Payment from superannuation fund [Section 10(13)]
26. House rent allowance (HRA) [Section 10(13A) Read with Rule 2A]
27. Any allowance given for meeting business expenditure [Section 10(14)]
28. Interest incomes [Section 10(15)]
29. Lease rental income of a foreign government or foreign enterprise from leasing of aircraft/aircraft engine to an Indian company [Section 10(15A)]
30. Scholarship [Section 10(16)]
31. Allowance of MP/MLA/MLC [Section 10(17)]
32. Awards instituted by government [Section 10(17A)]
33. Pension received by certain winners of gallantry awards [Section 10(18)]
34. Family pension received by family members of armed forces including paramilitary forces [Section 10(19)]
35. Income from one palace of a former ruler [Section 10(19A)]
36. Income of a local authority [Section 10(20)]
37. Income of scientific research association [Section 10(21)]
38. Income of a news agency [Section 10(22B)]
39. Income of some professional institutions [Section 10(23A)]
40. Exemption of income received by regimental fund [Section 23AA]
41. Income of a fund set-up for the welfare of employees or their dependents [Section 10(23AAA)]
42. Income of a pension fund set up by LIC or other insurer [Section 10(23MB)]
43. Income of institutions established for development of Khadi and village industries [Section 10(23B)]
44. Income of state-level Khadi and Village Industries Board [Section 10(23BB)]
45. Income of certain authorities set up to manage religious and charitable institutions [Section 10(23BBA)]
46. Income of European Economic Community [Section 10(23BBB)]
47. Income of a SAARC fund for regional projects [Section 10(23BBC)]
48. Any income of Insurance Regulatory and Development Authority [Section 10(23BBE)]
49. Income of Prasar Bharti [Section 10(23BBH)] [Inserted by the Finance Act 2012, w.e.f. 2013-14]
50. Any income received by a person on behalf of following funds [Section 10(23C)]



51. Income of mutual fund [Section 10(23D)]
52. Exemption of income of a securitisation trust [Section 10(23DA) [w.e.f. AY2014-15]
53. Income of investor protection fund [Section 10(23EA)]
54. Income of the Credit Guarantee Trust for Small Industries [Section 10(23EB)]
55. Exemption of income of investor protection fund of depository [Section 10(23ED)]
[w.e.f. AY2014-15]
56. Exemption for certain incomes of a venture capital company or venture capital fund
from certain specified business or industries [Section 10 (23FB)]
57. Income of registered trade unions [Section 10(24)]
58. Income of provident and superannuation funds [Section 10(25)]
59. Income of Employee's State Insurance Fund [Section 10 (25A)]
60. Income of Schedule Tribe Members [Section 10(26) and 10(26A)]
61. Income of Sikkimese individual [Section 10(26AAN) (With retrospective effect from
April 01, 1990)
62. Regulating the marketing of agricultural produce [Section 10[26AAB]
63. Income of a corporation set-up for promoting the interests of scheduled castes,
scheduled tribes, or backward classes [Section 10(26B)]
64. Income of a corporation set-up to protect the interests of minorities [Section
10(26BB)]
65. Any income of a corporation for ex-servicemen [Section 10(26BBB)]
66. Income of cooperative society, looking after the interests of scheduled castes or
scheduled tribes or both [Section 10(27)]
67. Any income accruing or arising to commodity boards, etc. [Section 10(29A)]
68. Amount received as subsidy from or through the tea board [Section 10(30)]
69. Amount received as subsidy from or through the concerned board [Section 10(31)]
70. Income of child clubbed u/s 64 (IA) [Section 10(32)]
71. Income from transfer of capital assets of UTI [Section 10(33)]
72. Income by way of dividend from Indian company [Section 10(34)]
73. Exemption of income to a shareholder on buyback of shares of unlisted company
[Section 10 (34A) [w.e.f. AY2014-15]
74. Income from units of UTI and other mutual funds [Section 10(35)]
75. Exemption of income from securitisation trust [Section 10(35A)] [w.e.f A.Y. 2014-
15]
76. Income from sale of shares in certain cases [Section 10(36)]

77. Capital gain on compulsory acquisition of urban agricultural land [Section 10(37)]
78. Long term capital gain on transfer of shares and securities covered under securities transaction tax (STT) [Section 10(38)]
79. Income from international sporting event [Section 10(39)]
80. Income received as grant by a subsidiary company [Section 10(40)]
81. Income from transfer of asset of an undertaking engaged in the business of generation, transmission, or distribution of power [Section 10(41)]
82. Income of a body or authority set up by two countries [Section 10(42)]
83. Reverse mortgage [Sec. 10(43)]
84. New Pension System Trust [Sec. 10(44)]
85. Exemption of allowance or perquisite to chairman/member of UPSC [Section 10 (45)]
86. Exemption of 'specified income' of certain bodies or authorities [Section 10(46)]
87. Exemption of income of notified 'infrastructure debt fund' [Section 10(47)]
88. Exemption of income of a foreign company from sale of crude oil in India [Section 10 (48)]
89. Exemption of income of National Financial Holdings Company [Section 10(49)] [w.e.f. AY2014-15]



Module 2: Fully Exempt Income under Section 10 of the Income Tax Act

There are certain types of incomes that are fully exempt from income tax as per Section 10. Key exemptions from an financial and investment point of view have been explained in greater detail in this module. The focus is on the heads of income that are relevant to individual assesseees.

Agriculture Income Exemption

- Agricultural income in India is exempt from tax. This includes any rent or revenue derived from land used for agricultural purposes or agricultural produce sold in the market.
- Any income from farm house, subject to certain satisfactory conditions specified in section 2(1A), would be exempt.

HUF/Estate Income Exemption

Any amount received out of family (HUF) income; or in the case of indivisible estates, income of any member from the family estate of such HUF is exempt from tax.

For example: Depending on their level of income, some HUFs are liable to pay tax while other HUFs are not. Either way, if an HUF pays out a share of its profits to any coparcener, then that amount will be tax-free in the hands of the coparcener. In this case, it does not matter if the HUF is paying taxes or is exempt.

Share of Profit from Partnership Firm

- As per section 10(2A), share of profit received from a firm by a partner is exempt from tax in his/her hands.
- Further, share of profit received from a limited liability partnership (LLP) by a partner will be exempt from tax in his/her hands.
- In the case of both partnership firms and LLPs, it is only the share of profits that will be tax-free. Other incomes like interest on capital will be taxed as income in the hands of the partner.

Certain Interest to Non-Residents Indians (NRIs)

Any income earned by way of interest on certain notified securities, bonds (income by way of premium on the redemption of such bonds), or an NRE* account is exempt from tax in the hands of individual taxpayer.

*Any income by way of interest in an NRE Account in any bank in India shall be exempt from tax in case of an individual. An NRI account is a foreign currency account which is freely repatriable and thus not taxable in India.

Leave Travel Concession (LTC) Offered by the Employer

- Under section 10(5), an employee can claim exemption in respect of LTC paid by the employer as part of the salary package.
- This facility is available to all employees (i.e. Indian as well as foreign citizens)
- There are some basic conditions to availing LTC. It is only exempt twice in a block of four years and is payable from the place of work to the farthest point as per eligible travel method. Also, it is only exempt against actual original bills submitted and does

not include stay and food expenses. It is important that the employee is marked as absent during the period of the LTC claimed.

Remuneration Received by a Non-Citizen

- Such individuals include ambassadors or other officials of the Embassy, High Commission, or Legation of a foreign State in India, Consulate Officer of a foreign State in India, and trade commissioner or other official representatives of a foreign State in India.
- Remuneration received an employee of a foreign enterprise for services rendered in India, provided:
 - (a) the foreign enterprise is not engaged in any trade or business in India;
 - (b) the official's stay in India does not exceed 90 days in the financial year; and
 - (c) Such remuneration is not liable to be deducted from the income of the employer chargeable under this Act

Tax Exemption for Life Insurance Corporation (LIC) of India

Life insurance is taken by individuals as a protection against the uncertainty of death which may result in the loss of family income and resources. Thus, this particular earning from the policy qualifies for some special concessions. Any sum received under a life insurance policy is fully exempt in the following cases:

- If any sum received from the insurer on insurance of a dependent handicapped member [under subsection (3) of section 80DD].
- If any sum received from insurer when a dependent, or a member of family is suffering from a notified disease [under subsection (3) of section 80DDA].
- Any sum received under a key man insurance policy. A key man insurance policy is taken by a company on the life of its key employees or senior directors, where loss of life has larger implications for the future of the company in question.
- Any other policy (not being the case when sum received on the death of a person):
 - Policy issued before April 1, 2003 – Exemption available, i.e. no tax liability.
 - Policy issued on or after April 1, 2003, but before April 1, 2012 – Exemption available only when annual premium payable exceeds 20% of sum assured.
 - Policy issued on or after April 1, 2012 – Exemption available only when annual

premium payable exceeds 10% of sum assured.

- Policy issued on or after April 1, 2013, for a disabled person referred to in section 80U or a person with disease or ailment specified in section 80DDB – Exemption available only when annual premium payable exceeds 15% of sum assured.

- Any other policy (sum received on the death of a person) – Exemption available, i.e. no tax liability.

Payment from Statutory Provident Fund (when they are exempt)

Any payment received on statutory provident fund related to employer's contribution, interest, or amount received on termination is fully exempted from tax. However, it needs to be remembered that India still follows the EEE (Exempt, Exempt, Exempt) approach to taxing provident funds. Several committees have recommended shifting to the EET model where the contribution gets exemption and the interest is tax-free in all years except the year of redemption.

Specific Interest Incomes Exempt From Tax

Any interest income, by default, is treated as other income in the hands of the recipient and is taxed at the peak rate applicable to the assessee. However, there are certain specific cases where the Income Tax Act has made certain classes of interest income exempt in the hands of the assessee.



Here are some forms of interest earnings that are fully tax-exempt in the hands of the recipient:

- Interest/premium on select notified bonds, certificates, and deposits
- Interest on notified capital investment bonds
- Interest on notified relief bonds
- Interest on specifically notified bonds/debentures of public sector undertakings (PSUs)
- Interest on gold deposit bonds under the Gold Deposit Scheme (GDS), 1999, or deposit certificates issued under the gold monetization scheme of 2015

Stipend Scholarship Received Under Section 10(16)

- Scholarship is free (or subsidized) education awarded to exemplary students. It covers the cost of education like tuition fees and other related expenses.
- The scholarship could be from the government or a university, board, or trust, etc., and is exempt to the fullest amount.

Pension Received by Certain Winners of Gallantry Awards

Individuals who have received any of the gallantry awards mentioned below are exempted from paying taxes on their pension.

- Service to Central or State Government
- Awarded 'Param Vir Chakra', or 'Mahavir Chakra', or 'Vir Chakra', or such other notified gallantry awards

Also, any amount received as family pension by a family member of such individuals will also qualify for exemption.

Exemption to a Shareholder on Buyback of Shares of Unlisted Company(ies)

Any income that a shareholder accrues from the buyback of shares by an unlisted company, as referred to in section 115QA, will be fully exempt from tax.

Income From Units of UTI and Other Mutual Funds (Section 10-35 of the IT Act)

All the below following are exempt:

- Dividend income covered under section 115-O
- Income in respect of units of a mutual fund
- Income received by unit holder of UTI
- Income earned by other such specified units

However, there was a small amendment to this clause in the Union Budget 2018.

According to this amendment, dividends received from an equity fund will be tax-free in the hands of the investor but will attract a dividend distribution tax of '10%+surcharge+cess' and the investor will only receive the net dividend.

Secondly, in case of profits made from sale of mutual funds held over one year (long-term), all capital gains above the cap of Rs1 lakh earned in equity funds after April 01, 2018, will be taxed at a flat rate of 10%. For short-term holdings, i.e. funds held for less than 1 year,

Income earned by Mutual Funds will be tax-free under Section 10 (23D) of the IT Act

Any income of following mutual funds (subject to provisions of sections 115R to 115T) is fully exempt from tax. This is to facilitate a 'pass-through' status to mutual funds to reduce their cost of transacting.

- A mutual fund registered under the Securities and Exchange Board of India (SEBI) Act or regulation made thereunder.
- A mutual fund set-up by a public sector bank, or a public financial institution, or authorised by the Reserve Bank of India (RBI) (subject to conditions notified by the central government).

Exemption of Income From Securitization Trust

This is an extension of the mutual fund argument where the trust status of a mutual fund is extended to such securitization trust. This was amended recently to make the pass-through status possible so that it could result in the development of a market for real estate investment trusts (REITs) and infrastructure investment trusts (InvITs) in India. Any person who is an investor in a securitization trust and receives any earning by way of distributed income from said trust shall be exempt from paying tax.

Income From Sale of Shares in Certain Cases

Any income arising from the transfer of long-term capital assets that are eligible equity shares that were held for a period of 12 months or more shall be exempt. This is subject to modifications from time to time.

Capital Gain on Compulsory Acquisition of Urban Agricultural Land

Any income chargeable under the head “capital gain” that has arisen from the transfer of agriculture land shall be exempt. However, such incomes need to be disclosed explicitly in the income tax returns.

Long-Term Capital Gain on Transfer of Shares and Securities Covered Under Securities Transaction Tax (STT)

For long-term capital gains from equities to qualify for preferential tax treatment status, the following conditions should be satisfied:

- At the time of asset transfer, transactions must be liable to STT
- The assets include equity shares, or a unit of a business trust, or units of an equity-oriented mutual fund
- It must be a long-term capital asset, i.e. held beyond 12 months
- Transfer must have taken place on or after October 1, 2004

Effective April 01 2018, there has been a slight modification to this exemption. Long-term capital gains (LTCG) over Rs1 lakh in a financial year will attract a flat tax rate of 10%. This flat tax would have to be paid without the benefit of indexation and even if the STT was paid at the time of the transaction.

Reverse Mortgage under Section 10(43) of the Income Tax Act

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Any amount received by an individual as a loan, either lump sum or in instalments, in a transaction of reverse mortgage referred in clause (xvi) of Section 47 shall be exempt. A reverse mortgage is where the owner of the property reverse lends to an aggregator to earn regular rental income on the same.

Section 10(44): New Pension System Trust

Any income received by any person for or on behalf of the New Pension System Trust established on February 27, 2008, shall be exempt.

Section 10(47): Exemption of Income of Notified ‘Infrastructure Debt Fund’

It shall be exempt from income tax when the fund is set up as per the prescribed guidelines and notifications issued by the government in this regard.

Section 10(49): Exemption of Income of National Financial Holdings Company

Any income of the National Financial Holdings Company, being a company set up by the central government, shall be exempt.

SECTION 3 - Incomes Partially Exempt under Section 10 of the IT Act

This category includes allowances that are exempt up to certain limits specified in the Income Tax Act. For certain allowances, exemption depends on the amount of allowance spent for the purpose for which it was received; for other allowances, there is a fixed cap on exemption. These are as follows:

House Rent Allowance (HRA) Exemption

An allowance granted to a person by his employer to meet expenditure incurred on payment of rent in respect of residential accommodation occupied by the former is exempt from tax to the extent of least of the following:

- House Rent Allowance (HRA) actually received by the assessee
- Excess of rent paid less 10% of salary* due to him
- An amount equal to 50% of salary due to assessee

Let us understand this with an illustration. Rakesh Sinha receives HRA of Rs.1.5 lakh per annum and his total Basic + DA is Rs.6 lakh per annum. He is currently paying rent of Rs.1.6 lakh per annum for an apartment in Mulund, Mumbai.

In the case of Rakesh, the exemption amount will be the least of the three, i.e.:

Actual	HRA:	Rs.1,50,000
Rent paid – 10% of (Basic + DA) =	(Rs.1,60,000 – Rs.60,000) =	Rs.1,00,000
50% of salary =	Rs.3,00,000	

In the above example, the minimum amount exempt will be Rs.1 lakh out of HRA. So, out of an HRA of Rs.1.5 lakh, Rs.1 lakh will be exempt and Rakesh will have to pay tax on the balance HRA of Rs.50,000 per annum.

Entertainment Allowance

This allowance is first included in gross salary under allowances and then deduction is allowed. In the case of government employees, the least of the following is exempt:

1. Rs.5,000
2. 20% of salary
3. Entertainment allowance actually received

Leave Encashment for Government Employees [Section 10(5)]

For government employees, leave encashment upon retirement or leaving the job is tax free under Section 10. For non-government employees, it is exempt up to the least of the following:

- Earned leave (no. of months) multiplied by the average monthly salary
- 10 multiplied by average monthly salary
- Rs.3,00,000
- Actual leave encashment received

Superannuation Fund Taxability

A pension fund created by a company for its employees' benefit paid after retirement or withdrawal with approval of the commissioner of income tax is exempt up to Rs.1,50,000. Moreover, the entire interest accumulated on such fund is also exempt.

Prescribed Allowances or Benefits

As per Section 10(14), certain allowances like Children Education Allowance, Children Hostel Allowance, Underground Allowance, Field Area Allowance, Travel Allowance to meet the cost of official tours, Helper Allowance, Uniform Allowance, Research Allowance, Hill Area Allowance, Remote Area Allowance are all exempt up to prescribed limits.

Recognised Provident Fund Receipts

The IT Act prescribes clear exemptions for PF contribution, interest income, and redemption as under. Any amount received against recognized provident fund by way of will entail exemptions up to limits specified hereunder:

- Employer's contribution: Exempt up to 12%
- Interest: Exempt up to 9.5%
- Amount received on termination: Fully exempt

Gratuity Exemption under Section 10(10)

There are separate rules for gratuity exemption in the case of government employees and non-government employees covered under the Payment of Gratuity Act, 1972.

The amount received by government employees (i.e. central, state, or local) for death-cum-retirement is fully exempt.

Gratuity income received by employees covered under the Payment of Gratuity Act, 1972, is exempt from income tax to the extent of the least of the following:

- 
- 15 day's salary multiplied by years of services
 - Maximum amount: Rs.20 lakh
 - Amount actually received

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The exemption limit of gratuity was recently enhanced to Rs.20 lakh from Rs.5 lakh earlier.

Section 10(10a): Commuted Pension Taxability

- The full amount of commuted value of pension received is exempt if it is received from the government, a local authority, or a statutory corporation.
- Any payment in commutation of pension received under any scheme from any other employer to the extent it does not exceed:
 - (a) In cases where the employee receives any gratuity, the commuted value of 1/3rd of pension which he is normally entitled to receive
 - (b) In any other case, the commuted value of 1/2 of such pension

Leave Encashment Exemption in Specific Cases

- Central & state government employees: Any payment received as the cash equivalent of the leave salary in respect of the earned leave at his credit at the time of his retirement shall be fully exempt.
- Other employees: Any payment received as the cash equivalent of the leave salary at his credit at the time of superannuation shall be exempt up to least of the following:
 - (a) Actual amount received
 - (b) (Average salary means average of salary drawn by the employee in the 10 months immediately preceding his retirement)
 - (c) Cash equivalent of leave salary due at the time of retirement
 - (d) Notified limit: Rs.3 lakh

Amount received in excess of the least of the above shall be taxable at rates applicable to individual assesses.

Retrenchment Compensation Paid to Workmen

As per Section 10(10B), compensation received at the time of retrenchment is exempt from tax to the extent of the least of the following:

- An amount calculated in accordance with the provisions of Section 25F(b) of the Industrial Dispute Act, 1947
- Maximum amount specified by the Central Government (Rs.5 lakh)
- Actual amount received

Section 10 of the Income Tax Act forms one of its key bases by defining the negative list of incomes that are either fully exempt or partially exempt. This is the basis of determining tax liability as any head of income that does not fall under the Section 10 category is automatically fully taxable in the hands of individual assessee.

HRA and LTA Calculations and Eligibility

One of the basic purposes of salary structuring is to ensure that an employee is able to legitimately reduce the liability of income tax to the maximum extent possible. The Income Tax Act offers numerous methods of salary structuring to this effect.

Two such means of saving tax on income are the House Rent Allowance (HRA) and the Leave Travel Allowance (LTA).

HRA is designed to give exemptions on the rent that assessee pay for their residential stay. It should be remembered that the HRA benefit is not available on rent paid for running any activity other than residence. Also, the rent must be paid in any mode other than cash such as cheque, DD, Pay Order, NEFT, RTGS, IMPS, etc., where there is an audit trail available with the bank. As per the latest rules, the HRA benefit is only available if the assessee can furnish stamped receipts for rent paid and the rental payment is supported by a registered rent deed. An online deed registration is good enough.

LTA, on the other hand, is an allowance for individuals to travel to and back from a single point via the lowest eligible fare. Only travel cost is permitted to be claimed as LTA and not other costs. The assessee is eligible to claim this for self, spouse, dependent children, and also for dependent parents.

Let us now look at these two components of income in greater detail.

LTA: Leave Travel Allowance

Leave Travel Allowance, or LTA, also popularly referred to as Leave Travel Concession (LTC), is a special type of allowance given to cover an employee's travel expenses when he is on leave from work. The word to note here is 'Allowance'. This means that it has two parts. To the extent you can produce requisite bills and proof of travel twice in a block of four years, it becomes a reimbursement and the balance becomes a taxable allowance. Let us understand this with an example.

Illustration 1

Chandresh received Rs.76,000 as LTA in FY18 . During the year, he travelled to Rameshwaram and back as part of a family holiday. His expenses on the trip were as follows:

Tickets:		Rs.55,000
Hotel	Stay:	Rs.23,000
Food:	Rs.8,000	

In the case of Chandresh, only the ticket fare of Rs.55,000 will be eligible to be included as an exempt portion of LTA. The balance of Rs.21,000 will be added back to his income and taxed at his normal rate. Observe here that the hotel expenses and food expenses are not eligible for deduction under LTA.

LTA is exempt from tax u/s 10(5) of the Income Tax Act, 1961, subject to certain conditions. It qualifies as an allowance that is either fully or partially exempt depending on the conditions that are met.

Types of LTA

There are two types of LTA that employees can receive from their employer.

Firstly, there is any travel concession or assistance the employee receives (for himself or his family) from his employer to cover expenses incurred while travelling on leave. The exemption is only for travelling expenses and nothing else.

Secondly, if there is any travel concession or assistance the employee receives (for himself or his family) from his former employer to cover expenses incurred while travelling post retirement or termination of service.

In case of a mid-way resignation or termination of services, employers are obliged to provide proportionate LTA benefit to their former employees. This also falls under the definition of LTA/LTC.

We also need to understand the definition of 'family' quite clearly here. For the purpose of LTA eligibility calculation, family includes the individual (employee), his/her spouse, his/her children, his/her parents (principally or wholly dependent), and his/her siblings (principally or wholly dependent).

Key highlights of the LTA benefits for employees

LTA can be claimed twice in a period of four years. The blocks are defined clearly in the Income Tax Act as under:

Block 1	Block 2	Block 3	Block 4	Block 5

1986-1989	1990-1993	1994-1997	1998-2001	2002-2005
Block 6	Block 7	Block 8	Block 9	-
2006-2009	2010-2013	2014-2017	2018-2021	-

- The above table captures the blocks of years with both the ends inclusive. We are current in the ninth block of LTA and we shall see later why this concept and the interpretation of these blocks is important to the individual.
- Only travel expenses can be claimed under LTA for tax exemption eligibility. Therefore, other expenses like food, stay, hop travelling, entertainment, and shopping, etc., are not eligible for LTA exemption even if you are willing to produce proofs of monies spent. All LTA exemptions are only available against original proofs of travel. Therefore, remember to keep all the proofs and documents safe and secure with you. In case of air travel and train travel, e-tickets can be produced. However, in case of booking through travel agents, the original invoice should also be produced. Photocopies are not permitted.
- An important pre-condition of LTA is that only the expenses actually borne by the employee on travelling are eligible for tax reimbursements/concessions. Apart from submitting the originals to the employer, the employee also has to keep a photocopy of all the proofs handy in case of query from the Income Tax department. Exemption is allowed for only two travels within a block of four years.
- Producing legitimate proofs of travel is not a guarantee that you are eligible for LTA exemption. For example, if you are eligible for AC-II travel (eligibility Rs.18,000) and you travelled by air (costing Rs.26,000), then the employer will only refund Rs.18,000 and the balance of Rs.8,000 will be added back to your income and taxed at the normal rate. The amount of exemption is decided on the mode of transportation chosen and connectivity of the place.

Understanding the concept of LTA blocks in greater detail

We have already captured the nine four-year blocks for LTA exemption in the table above. The reason these blocks are important is that exemptions can be claimed twice during each block period. This is the basic concept on which LTA calculation is based and the eligibility is decided. The current or on-going block year is the ninth one, and the four years that make it up are 2018, 2019, 2020, and 2021.

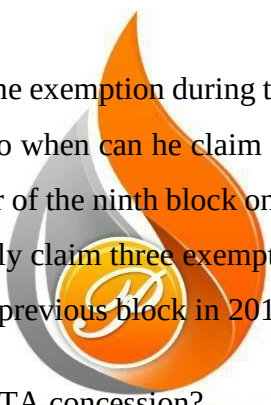
But what if you used only one LTA exemption in the previous (8th) block (2014-2017)? Are you eligible to carry forward the LTA to the next block? This is where the concept of carry over concession (COC) comes into play. Let us see how COC works in practice.

If the assessee did not use LTA provided by his employer either once or twice (the permitted limit) in a four-year block period, then he can still claim LTA exemption by using LTA in the year immediately succeeding the block period. This is known as carry over concession. So, if you used the LTA exemption only once in the previous block of 2014-2017, then the one concession you did not use can be carried forward and used in the year 2018 (year immediately succeeding the previous block and also the first year of the next block), but not after it. Let us understand this with an illustration.

Illustration 2

Suppose Raghav claimed only one exemption during the eighth block (2014-18). He still has one exemption remaining. So when can he claim it? He can claim this concession in the next year, i.e. 2018 (first year of the ninth block only). Thus, in the ninth block period (2018-21), Raghav can effectively claim three exemptions in total, but he needs to claim the carry over concession of the previous block in 2018 only and not later than that.

What expenses are eligible for LTA concession?

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- In case of travel by air, the economy air fare of a national carrier by the shortest route or the actual amount spent on travel, whichever is less, is exempt from tax.
 - In case of travel by rail, the AC-I rail fare by shortest route or actual amount spent on travel, whichever is less, is exempt from tax.
 - If the origin and destination are connected by rail but the journey is performed by a mode of transport other than air or rail, then the AC-I rail fare by shortest route or actual amount spent on travel, whichever is less, is exempt from tax.
 - If the origin & destination points are not connected by rail or air (partly/fully) but are connected by other recognized public transport systems, then the first class or deluxe class fare of such transport by shortest route or actual amount spent on travel, whichever is less, is exempt from tax.
 - If the place of origin & destination are not connected by rail or air (partly/fully) and also not connected by other recognized public transport system, then AC-I rail

fare by shortest route (assuming that the journey was performed by rail) or the amount actually spent on travel, whichever is less, is exempt from tax.

What is not eligible for LTA concession (negative list)?

- Any international travel, i.e. outside the shores and borders of India, is not eligible for LTA concessions. LTA only covers domestic travel, i.e. travel within India.
- Any mode of transport other than air, railway, or public transport is not eligible for LTA. For example, private cruises are not eligible for LTA exemption.
- Any expenses other than for direct travel are not eligible for LTA concession. Also, any detours are not eligible; only point-to-point expenses are covered.
- Tax exemption on LTA cannot be claimed for more than two children of an individual. This restriction is not applicable if the children were born before October 1, 1998.
- Children born out of multiple births (twins/triplets, etc.) after the first child will be treated as one child only. So the above mentioned restriction will not be applicable in this case.

Illustration 3

Nayan, an employee of Satara Iron & Steel Ltd., travelled from Pune to Hyderabad and back via a business class flight. His total spend on the air tickets was Rs.35,000. The economy class return air fare (which Nayan is eligible) is, however, Rs.18,000. Hence, in this case, Nayan is only eligible to claim an LTA benefit to the extent of Rs.18,000. Even though he has legitimately spent Rs.35,000, the balance Rs.17,000 will be taxable at normal rates and won't be available for LTA exemption. Irrespective of what you actually spend, the LTA eligibility is only to the extent of actual expenditure or eligibility, whichever is less.

HRA: HOUSE RENT ALLOWANCE

When moving to a different city to work, one of the first things a person looks for is suitable accommodation. Normally, rental costs eat up a large chunk of our monthly outflows and hence, the IT Act has provided for special concessions to reduce the tax burden on income. For claiming the benefit of HRA, the HRA allowance must be a

specific part of your appointment letter and also has to be part of your monthly pay slip. Only then can you claim the benefits of HRA.

How is HRA calculated for Indian employees?

For tax purposes, the least of the following three is deductible from your total income and only the balance is taxable as your salary income. This HRA exemption helps you to substantially reduce your taxable income and your tax liability by extension.

These three items are:

- Actual HRA received
- 50% of 'Basic salary + DA' for those living in metro cities (40% for non-metros)
- Actual rent paid less 10% of basic salary + DA. If there is no DA, then only basic salary will be considered for this purpose.

Let us understand the calculation of HRA with an actual example.

Illustration 4

Rajesh Shah is employed as an engineer with KSB Pumps Ltd. in Delhi (remember, Delhi being a metro city, Item b above will be taken as 50%).

Rajesh paid a monthly rent of Rs.30,000 during FY2017-18 i.e. Assessment Year (AY) 2018-19. KSB Pumps Ltd. pays him basic monthly salary of Rs.50,000 along with dearness allowance (DA) of Rs.4,000. He also receives HRA of Rs.2,00,000 (annually) from his employer during the year.

Let us understand how the HRA component would be exempt from income tax during FY2017-18 for Rajesh's tax calculations.

No	Particulars	Amount (R)	Amount (R)
1	Actual HRA received	--	2,00,000
2	Rent paid (30,000 pm*12 months)	3,60,000	2,95,200
	- 10% of {(50,000pm*12 months) + (4,000 pm* months)} i.e. 10% of Basic + DA	64,800	

3	50% of $\{(50,000 \text{ pm} \times 12) + (4,000 \text{ pm} \times 12)$ (50% is considered as the accommodation in Delhi)		3,24,000
4	Exempt HRA = lowest of 1, 2, & 3		2,00,000

In the above case, the lowest of the three items (Rs.2 lakh) is the actual HRA received. Hence, the entire HRA will be exempt for Rajesh Shah and will be deducted from his taxable income. This is the benefit of HRA component in the taxable income for individuals.

What if you own an apartment, also pay rent, and are getting HRA?

There is a normal misconception among many assesseees that if you have an apartment of your own and are claiming benefits under Section 24 of the Income Tax Act, then you are not eligible to claim HRA benefits. That is not correct. Despite having your own apartment and claiming the benefits of Section 24, you can claim the HRA benefit as it has no bearing towards your home loan interest deduction and both can be claimed.

The only thing you require to claim HRA is an HRA component inclusion in your appointment letter and salary slip, a registered lease agreement with the landlord, and stamped monthly rent receipts signed by the landlord or his or her authorized signatory / power of attorney.



Requirement of landlord's PAN

If you have taken a house on rent and are making a payment in excess of Rs.1,00,000 annually, remember to obtain the landlord's PAN or you may lose out on the HRA exemption. This is a statutory requirement. Landlords without a PAN must be willing to give you a declaration to that effect. There is also an aspect of TDS deduction in the case of payment of rent. Any rent payment in excess of Rs.50,000 per month entails a TDS of 10% to be deducted.

As a tenant you need to deposit the TDS with the government and you an issue the TDS certificate to your landlord accordingly. Tenants paying rent to NRI landlords must remember to deduct TDS of 30% before making the payment towards rent.

You can get exemption on rent even if you don't get HRA

This is an interest benefit to know of. If you are making payments towards rent for any furnished or unfurnished residential accommodation occupied by you but do not receive HRA from your employer, you can still claim a deduction under Section 80GG.

In this case too, the least of the following three items will be exempt:

- a. Rs.5,000 pm
- b. 25% of adjusted total income (excluding capital gains)
- c. Actual rent less 10% of adjusted total Income*

You will be required to file Form 10BA with details of payment of rent.

**Conditions that must be fulfilled to claim this deduction:*

- a. You are self-employed or salaried
- b. You have not received HRA at any time during the year for which you are claiming 80GG
- c. You or your spouse or your minor child or HUF, of which you are a member, do not own any residential accommodation at the place where you currently reside, perform duties of office, or employment, or carry on business or profession.

In the case where you own residential property at any place other than the place mentioned above, then you should not claim the benefit of that property as self-occupied. That other property would be deemed to be let out in order to claim the deduction under Section 80GG.

It is advised to use this section very judiciously and only if you meet all the criteria above, not otherwise.

Did you know that you can claim HRA even if you live with your parents?

If your company provides you with house rent allowance (HRA) and you live with your parents, then you are still eligible to claim HRA benefits. You can pay the rent to your parents and claim the allowance provided. You just need to enter into a formal rental

agreement with your parents and ensure that the money is transferred by banking channels. Cash transfers are not permitted.

Remember, HRA and LTA are very useful tools for reducing your tax liability.

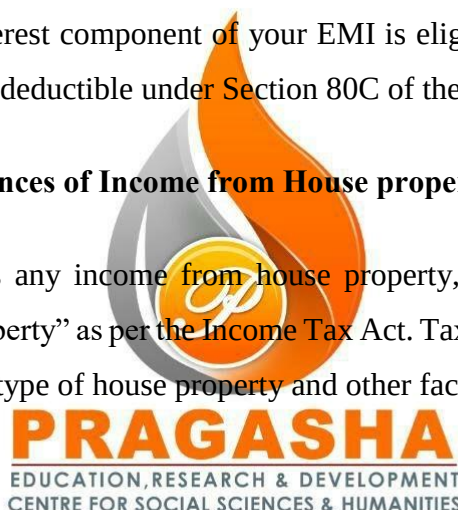
Income from House Property and deductions under Section 24

When an individual purchases a property, there are several possibilities. Either one could stay in the property, in which case it will be classified as Self-Occupied property or one could let out the property, in which case the rent received on the property will have to show as income under the category of rental income. However, in both the cases, Section 24 of the Income Act permits one to claim exemption for the interest paid on home loan taken to purchase the property. This home loan can be taken from any eligible lender. Remember, only the interest component of your EMI is eligible for this benefit and the principal portion will be deductible under Section 80C of the Income Tax Act.

Understanding the nuances of Income from House property...

When an assessee earns any income from house property, it is taxed under the head “Income from house property” as per the Income Tax Act. Tax calculation on such income varies depending on the type of house property and other factors.

Illustration 1



The table given below shows how you can calculate Income from House Property:

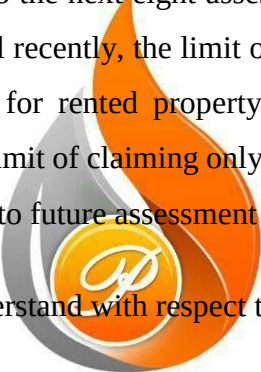
Calculation of Income from House Property	Amount
Gross Annual Value	Rs.500,000
Deduct: Municipal Taxes paid	Rs.10,000
Net Annual Value	Rs.490,000
Deduct: Exemption for interest on property loan u/s 24 of the IT Act	Rs.1,35,000
Taxable Income from Property	Rs.3,55,000

When calculating the income from house property, in case you hold multiple properties, the total of income from all those properties will be treated as income from house property

and added to your total income. Now, the question is what happens in case of self-occupied property. It's simple: you just take the gross annual value (GAV) as Rs.0. Then, the interest amount of Rs.1,35,000 is fully deductible (if it falls within Rs.2 lakhs), and you can show your income from property as (-Rs.135,000) a loss on house property that can be written off against your total income and your taxable income can be reduced proportionately.

Thus, if the income under the head “house property” is negative (loss), you can offset that loss against your other taxable income including salary. However, Budget 2017 has put a cap of Rs.2 lakh on loss from house property, which can be adjusted against income from other heads in a financial year. This implies that starting 2017-18, you will be able to offset a maximum Rs.2 lakh loss on house property against your other income, and the balance can be carried forward to the next eight assessment years to be adjusted against income under the same head. Till recently, the limit of Rs.2 lakh was only applicable for self-occupied property and not for rented property. Now, even rented property will indirectly come under the outer limit of claiming only up to Rs.2 lakh per annum, and the balance must be carried forward to future assessment years.

Basic terms and concepts to understand with respect to Section 24

- 
- Annual value: It is the capacity of the property to earn income.
 - Municipal value: It is the value of the property as derived by municipal authorities.
 - Fair Rental Value: It is an assumed rental value of the property that is calculated by comparing it with a property having similar features.
 - Standard rent: It is the fair value of rent as prescribed by the Rent control Act, which ensures that tenants are not exploited while owners receive a fair amount of rent.
 - Actual rent received/receivable: It is the actual amount of rent received by the owners from the tenants.

It must be noted that Section 24 is slightly different from Section 80C in the sense that Section 24 benefits are available on accrual and not on actual payment basis. Thus, once your EMI is due, even if you have not paid your EMI on time, you can claim the benefit under the Income Tax Act - Section 24.

How is the GAV calculated?

GAV is the highest of the following three terms:

- a) Rent received or receivable
- b) Fair Market Value
- c) Municipal Valuation
- d) Standard Rent if the Rent Control Act is applicable

Illustration 2

Mr. Savant has let out his property on rent and the rent charged is Rs.75,000 per annum. If the municipal valuation is Rs.60,000 and the Fair Market Value as calculated on like properties is Rs.90,000, the amount of Rs.90,000 will be taken as the GAV of your property even though you are receiving only Rs.75,000 as actual rent. This GAV is the base for tax on house property calculation.

Importance of the Net Asset Value (NAV) of the property

$$\text{NAV} = \text{GAV} - \text{Municipal Taxes Paid}$$

Remember, if your property is self-occupied and your GAV is zero, you cannot claim deduction for municipal taxes as well. The benefit of municipal tax can only be claimed if the property shows rental income in the IT return. You don't have to pay tax on the NAV. There are two more additional deductions available to you from the NAV

- Standard Deduction which is 30% of the NAV, which is allowed as a flat deduction towards repairs, rent collection, etc. This is irrespective of the actual expenditure incurred and no receipts or proofs are required. This deduction is not allowed if the GAV is nil; hence, it cannot be claimed in case of self-occupied property.
- Interest on home loan is allowed as a deduction under section 24.

When the above two deductions are reduced from the NAV, you get the taxable NAV, which is included in the total income of the assessee.

Understanding owner vs. deemed owner in case of property...

The person who is entitled to receive the income is called the owner of the property, while the person who receives financial benefits from the property, but is not registered as its owner is called the deemed owner of the property. Income from house property is taxable for the person who actually receives monetary benefits from the property which may or may not be the registered owner of the property.

Two types of deductions are available under section 24

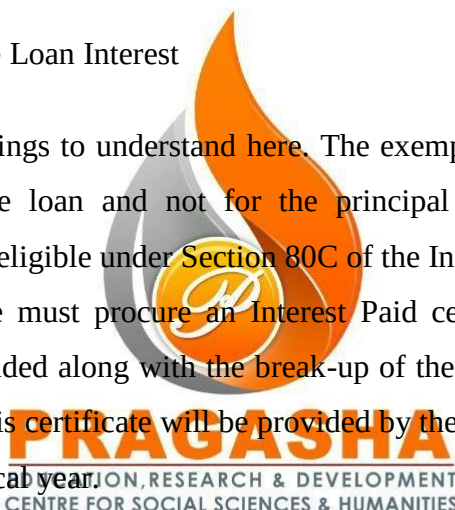
There are two types of benefits available under Section 24 of the Income Tax Act.

1) Standard deduction of 30% of the annual value

2) Interests paid on home loan

Tax Deduction for Home Loan Interest

There are a few basic things to understand here. The exemption is only for the interest component of the home loan and not for the principal component. The principal component is separately eligible under Section 80C of the Income Tax Act. For claiming the benefit, the assessee must procure an Interest Paid certificate from the financier, wherein details are provided along with the break-up of the interest component and the principal component. This certificate will be provided by the bank on a provisional basis by December of each fiscal year.



- The maximum tax deduction you can get on interest payment of home loan taken for a self-occupied property is Rs.2 lakhs. Your eligibility will be either the actual interest paid or Rs.2 lakh, whichever is less.
- In case the property for which the home loan has been taken is not self-occupied, i.e., rented or deemed to be rented, no maximum limit for tax deduction has been prescribed and the taxpayer can take deduction of the entire interest amount under section 24. However, if the owner has not occupied the property himself due to his employment, business or profession carried on at any other place, which has forced him to reside at any other place, the amount of tax deduction available stays limited to Rs.2 lakh only. Effective the latest fiscal year, only negative income up to Rs.2 lakh can be carried forward to the IT statement and the rest can be carried forward to the next eight assessment years.

- It is also important to note that this tax deduction of interest on home loan under section 24 is deductible on payable basis, i.e., on accrual basis. Hence, the deduction should be claimed on a yearly basis even if no payment has been made during the year as compared to section 80C (deduction on principal repayment), where deduction is allowed only on an actual payment basis. However, the catch is that your bank will not give you the interest paid certificate unless you pay the amounts promptly and in full.
- The benefit of Section 24 will be given depending on the completion of construction of the property. The tax benefit under Section 24 is reduced from Rs.2 lakh to Rs.30,000, if the property is not acquired or construction is not completed within three years from the end of the financial Year in which the loan was taken. This limit of three years has been increased to five years from FY2016-17 onwards.

How to account for pre-construction interest paid on home loan?

The big challenge for borrowers is that loan servicing starts almost immediately, while possession is received only after a gap of six months to a year. During this period, the bank does not charge EMIs, however, interest is charged. This is called as the pre-construction interest paid. Deduction on pre-construction interest is allowed when you have taken a loan for the purchase or construction of house property. However, if the loan is taken for repairs or reconstruction, deduction is not allowed. The deduction for former category interest is allowed in five equal instalments starting from the year in which the house is purchased or in which the construction is completed. For example, if you paid pre-construction interest of Rs.80,000, it can be split into Rs.16,000 per year and claimed as pre-construction interest for five years after the completion of the property construction.

However, the pre-construction interest benefit is not available to the assessee over and above the Section 24 limit of Rs2 lakh; it is carved into that limit. Though pre-construction interest is allowed to be claimed as tax deducted in five equal yearly instalments, which can be claimed at the beginning of the year in which the construction of property is completed, the total amount that can be claimed in a year is subject to a threshold of Rs.2,00,000 in case of a self-occupied house property. Therefore, this pre-construction

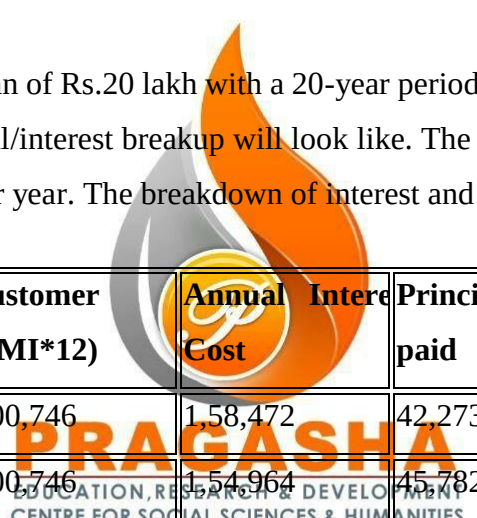
benefit is available to one only if one's annual interest component is less than Rs.2 lakh so that the benefit of pre-construction interest can also be claimed by the assessee.

Going beyond Section 24 - the principal component of a home loan

The home loan EMI has an interest component and principal component to it. Normally, in the initial years, the interest component is higher, and in the later years, the principal component is higher. The amount paid as repayment of the principal amount of home loan taken for the construction or purchase of a new house property by an individual/HUF is allowed as tax deduction under Section 80C of the Income Tax Act. Consider the illustration below to better understand the concept.

Illustration 3

Mayank took a home loan of Rs.20 lakh with a 20-year period and an interest rate of 8%. Here is how the principal/interest breakup will look like. The EMI will be Rs.16,729 per month or Rs.200,746 per year. The breakdown of interest and principal will be as under



Year	Opening Balance	Customer (EMI*12)	Annual Interest Cost	Principal paid	Loan Closing Balance
1	20,00,000	2,00,746	1,58,472	42,273	19,57,727
2	19,57,727	2,00,746	1,54,964	45,782	19,11,945
3	19,11,945	2,00,746	1,51,164	49,582	18,62,363
4	18,62,363	2,00,746	1,47,048	53,697	18,08,666
5	18,08,666	2,00,746	1,42,592	58,154	17,50,512
6	17,50,512	2,00,746	1,37,765	62,981	16,87,531
7	16,87,531	2,00,746	1,32,538	68,208	16,19,323
8	16,19,323	2,00,746	1,26,876	73,869	15,45,454
9	15,45,454	2,00,746	1,20,745	80,000	14,65,453
10	14,65,453	2,00,746	1,14,105	86,640	13,78,813
11	13,78,813	2,00,746	1,06,914	93,832	12,84,981
12	12,84,981	2,00,746	99,126	1,01,620	11,83,361

13	11,83,361	2,00,746	90,692	1,10,054	10,73,308
14	10,73,308	2,00,746	81,557	1,19,188	9,54,119
15	9,54,119	2,00,746	71,665	1,29,081	8,25,038
16	8,25,038	2,00,746	60,951	1,39,795	6,85,244
17	6,85,244	2,00,746	49,348	1,51,397	5,33,846
18	5,33,846	2,00,746	36,782	1,63,963	3,69,883
19	3,69,883	2,00,746	23,173	1,77,572	1,92,311
20	1,92,311	2,00,746	8,435	1,92,311	0

In the above illustration, the column colored in red represents the annual interest component and is eligible for deduction under Section 24 of the Income Tax Act. The column in purple shade represents the principal component, which is eligible for deduction under Section 80C of the Income Tax Act.

Deduction on the principal available under Section 80C

The maximum tax deduction allowed under Section 80C is Rs.1,50,000. The tax deduction on principal repayment is also a part of the various deductions allowed under Section 80C, which includes the amount invested in the PPF Account, tax saving fixed deposits, equity oriented mutual funds, national savings certificate, and senior citizens saving scheme. The deduction limit of section 80C is an umbrella limit and is inclusive of all these options. If you have exhausted your Section 80C limit with PF and ELSS, the principal component does not proffer you any additional benefit. This tax deduction is available on a payment basis and does not depend on the year for which actual payment has been made by the assessee. This is where it differs from the Section 24, which is available on an accrual basis.

An interesting snippet: The amount paid as stamp duty and registration fee is also allowed as a tax deduction under Section 80C. This deduction can be claimed, whether the assessee has taken a loan or not. However, this benefit can only be claimed in the year in which this amount is paid and cannot be carried forward to future years. Further, this benefit is independent of Section 24 and can be claimed under Section 80C even if you have not

taken a loan to buy the property. Only Section 24 is contingent on having taken a home loan.

Some key conditions to be eligible for claiming the benefit of principal under Section 80C of the Income Tax Act:

- This deduction can be claimed if and only if the construction of property is complete, and you have received a completion certificate for the same. You cannot claim the benefit during the pre-construction period. No deduction would be allowed under this section for repayment of principal for those years during which the property was under construction. Normally, banks charge only interest in pre-construction years.
- This deduction on the principal is agnostic of whether the property is self-occupied or rented out.
- The benefit can also be claimed for more than one house property.

There is also the aspect of reversal of the benefits under Section 80C benefits...

Once you have claimed the deduction under Section 80C, the house property cannot be sold in less than five years from the end of the financial year in which you received its possession. If you sell the property within this time limit, you will not be eligible to claim any deduction for the principal repaid during the current financial year, and the total amount of tax deduction already claimed in respect of earlier years shall be deemed to be your income of such year in which you sold the property, and you will be liable to pay tax on that income.

For example, if the property is sold after the completion of three years, then in the fourth year returns, the benefit claimed under Section 80C will be reversed and added back to your income. Hence, to continue to get the benefit of Section 80C, assessee's need to ensure that the property is not sold before the completion of five years from the date of purchase.

Section 80C of the Income Tax Act

Whether you are a salaried employee or a self-employed professional or even a homemaker, it is unlikely that you have not heard of Section 80C. Over the past, this

section has assumed various forms. It originally started off as an exemption from total income under the banner of Section 80C. This was later converted to a tax rebate under Section 88 where the tax was rebated at 20% of the contribution from the total tax payable. However, this has once again been shifted to the exemption format under Section 80C, which is where it stands today. The limits of Section 80C vary from time to time depending on the annual Union Budget announcement. Currently, the total exemption under Section 80C is restricted to Rs.150,000, which is the consolidated blanket exemption available.

Understanding Exemption vs. Rebate

What is the difference between an exemption and a rebate? A rebate is a direct reduction from the tax payable, whereas an exemption is a reduction in the taxable income. From the point of view of an individual assessee, exemption is more useful in the above case.

In case of exemption, the amount is deducted from the total taxable income, hence, the effective tax shield on the investment of Rs.150,000 is Rs.46,200 (31.2% of 150,000). Of course, if your income is above Rs.50 lakh, then there is also a surcharge of 10% payable and if it is above Rs1cr, a surcharge of 15% is applicable. In such cases, the effective tax shield becomes even higher. On the contrary, in case of rebate, you get only 20% rebate under Section 88, which makes it less effective for an individual assessee.

The exemption of Rs.150,000 under Section 80C of the Income Tax Act is applicable for all eligible contributions made during the financial year. For example, all incomes and investments made between April 01st 2017 and March 31st 2018 pertain to the Financial year 2017-18 corresponding to the Assessment Year 2018-19.

What is 80C in Income Tax and who is eligible for this exemption?

Section 80C comprises various investments and expenses that are eligible for tax deductions. A taxpayer can claim maximum tax deductions of Rs.1.5 lakh for a particular financial year (FY) from his/her taxable income through investments made by him/her under section 80C of the Income Tax Act, 1961. Even if your total eligible investments are above Rs.1.50 lakhs, the exemption for the purpose of Section 80C is only restricted to a contribution of Rs.1.50 lakhs.

Only individuals or Hindu Undivided Family (HUF) will be eligible for claiming tax deduction u/s 80C. Broadly, there are two classes of outlays that qualify for the 80C exemption: Eligible Investments and Eligible Expenditures

SECTION 1 – ELIGIBLE INVESTMENTS UNDER SECTION 80C OF THE INCOME TAX ACT

The following investments are eligible for deductions u/s 80C. An investor can choose to either invest in all the available tax-saving instruments or in some of them. Remember, that the total umbrella exemption is Rs.150,000 and the individual is free to choose which specific investments he or she wants to opt for. We cover below some popular instruments where a person can invest in to claim the exemption under Section 80C of the Income Tax Act.

Employee Provident Fund (EPF) & Voluntary Provident Fund (VPF)

EPF is a retirement benefit scheme that is available to all salaried employees. The employer and the employee both have to contribute equally (12% of basic salary) to the provident fund account of an employee. The government is now proposing to reduce the mandatory contribution from 12% to 9%. An employee can contribute a higher sum of money through voluntary contributions (VPF). Only the employee's own contribution to provident fund qualifies for 80C deductions. The employer contribution is tax-free in the hands of the employee and does not qualify for benefits under Section 80C of the Income Tax Act.

Who is eligible: If the employee's basic salary exceeds Rs.15,000 per month, he/she has an option to join the scheme, otherwise, he/she has to compulsorily contribute towards provident fund.

Are they liquid: A person cannot withdraw his/her PF balance for as long as he/she continues to work, except in special circumstances (flat, construction, marriage/education of children, etc.). In case, he/she quits the job and does not take up employment within two months with an employer covered by the PF Act, he/she can withdraw the entire balance. Any withdrawal from the PF account is totally tax-free under most circumstances. Provident funds are long-term investments, and hence, they are not liquid.

What is the rate of interest payable on PF: The rate of interest on provident funds is announced by the Provident Fund Commissioner from time to time and changes with the prevailing interest rates in the market. The current rate of interest is 8.65% p.a. to be realigned on a quarterly basis. Interest is accrued and cumulated with your PF contribution.

What are the investment limits for EPF: Both the employer and the employee have to contribute a minimum of 12% of their Basic Pay + D.A. However, this is now likely to be reduced to 9% to leave more disposable income in the hands of the employee. Employees can voluntarily increase their own contribution without any upper limit.

How is EPF taxed at different levels: The EPF falls under EEE (Exempt, Exempt, Exempt) category. Employer's contribution to the PF account up to 12% of the salary is tax exempt. Employee's own contribution qualifies for deduction under section 80C within the overall limit of Rs.150,000. The entire accumulated balance (including interest) of PF is tax exempt if withdrawn after a continuous service of five years. Any withdrawal before that invites taxation in the year of withdrawal.

Public Provident Fund (PPF)

This has all the characteristics of a CPF, but it is voluntary and anyone can go to the post office or a bank branch and open a PPF account. PPF scheme is a long-term investment option backed by the Government of India. Many individuals prefer PPF because the effective return on PPF if you consider the tax benefits is very high compared to other debt instruments in India.

Who is eligible: A PPF account can be opened by Resident Indian individuals either in their own name or in the name of a minor child. It can be opened by both salaried and non-salaried individuals. A HUF cannot open a PPF account.

Liquidity of PPF: The maturity period of a PPF account is 15 years, but it can be further extended by five years. Partial withdrawals are allowed after seven years. Premature closure is allowed after five years.

What is the rate of interest payable: The current interest rate is 7.9% p.a. (compounded yearly) to be realigned on a quarterly basis. Again, the interest is not paid out in cash, but is accrued to the PPF corpus.

Are there any investment limits in PPF: The minimum and maximum investment limits are Rs.500 and Rs.1.5 lakh, respectively. You cannot invest more than that per year in a single account.

Tax Treatment: Like CPF, PPF also qualifies for the EEE (Exempt, Exempt, Exempt) status. This implies that there is tax benefit at the time of investment, interest accrual, and redemption.

Equity Linked Savings Scheme (ELSS)

ELSS has become a very popular instrument in the last few years as it combines the benefit of tax exemption under Section 80C of the Income Tax Act along with the wealth creation potential of equity funds. In fact, ELSS is just another equity mutual fund with the added clause of a compulsory lock-in period of three years. ELSS has to necessarily be an open-ended Equity Mutual Fund. ELSS has emerged as an interesting class of mutual fund product as fund managers are able to take a more long-term view in ELSS funds due to the compulsory lock-in period.

Eligibility: The normal Mutual Fund Know Your Client (KYC) regulations need to be adhered to before being eligible to invest in ELSS funds.

Is ELSS liquid: There is a minimum lock-in period and the lock-in is applicable from the date of investment. So, a Jan 2015 ELSS investment will be locked in till Jan 2018 and a June 2016 investment in ELSS will be locked in till June 2019.

Does ELSS offer assured returns: As the return on investment is directly linked to stock market performance, there is no assurance of returns. It is just like an equity mutual fund. However, in the long run, ELSS has wide potential to provide you the best return on your investments. It is more suitable for a person with an appetite to take slightly greater risk. For new tax payers, ELSS is a good way to hit two birds with one stone. You can get the benefit of tax exemption and also see your wealth grow.

Investment Limit: The minimum investment limit is Rs.500. There is no upper limit for investment in this scheme. However, you can only get tax exemption under Section 80C up to an outer limit of Rs.150,000 per assessment year.

Tax Treatment: ELSS is also an EEE category investment, and therefore, is exempt at all three stages of the investment.

National Savings Certificate (NSC):

NSC is the postal department's saving scheme. Ranked as "highly secured" in the class of investments, it has the following features:

- NSC investments are only open for resident individual investors to invest in. Non-residents, Trusts, and HUFs cannot invest in this scheme.
- NSC comes with a lock-in period of 5 and 10 years, and one can choose the time frame based on one's requirements.
- The current interest rate on the scheme is 7.9% compounded annually for the 5 year NSC VIII Issue. This rate may change from time to time. However, interest accrued on NSC (no interest is paid out) will have to be shown in your tax returns as interest income, and this is fully taxable although you do not receive any interest in hand.
- Minimum investment limit is Rs.100. There is no maximum investment limit. In the old days this instrument was very popular as cash investments were permitted in NSC and there were no questions raised on the source of income. Now that is not possible and full KYC is essential.
- Interest accrued on the amount invested in NSC is taxable but it is counted as fresh investment and hence qualifies for 80C deduction. The investment is eligible for deduction under 80C and maturity amount is tax-free. Each subsequent year, the interest amount can also be added as Section 80C benefit.

Sukanya Samriddhi Scheme

Sukanya Samriddhi Scheme is an interesting scheme which is currently being publicized by the government. It is intended to take care of the welfare and future of the girl child. Here are some of the key highlights of the Sukanya Samriddhi Scheme.

- Parents/guardians can open an account in the name of a girl child till she attains the age of 10 years. A maximum of two accounts can be opened by a natural or legal guardian for two girls. The account can be opened at public sector banks and post offices.
- The deposit should be made every year till the end of 14 years from the year of opening the account. Partial withdrawals are allowed up to 50% of the balance in the account as per the end of the previous financial year, for the purposes of higher education or marriage after attaining the age of 18 years. The maturity period is 21 years post the opening of the account.
- The rate of interest currently being offered is 8.4%, compounded annually. This interest is accrued and reinvested in the fund.
- The minimum and maximum investment limits are Rs.1,000 & Rs.1.5 lakh p.a., respectively.
- Sukanya Samriddhi Scheme comes under the EEE category. This implies that it is tax-exempt at the three levels of investment, interest, and redemption.

Senior Citizens Savings Scheme (SCSS)

This is a special scheme for senior citizens aged above 60 to earn a slightly higher rate of interest on their investment compared to the normal investment instruments of a similar category. Following are some of the key highlights of the SCSS scheme.

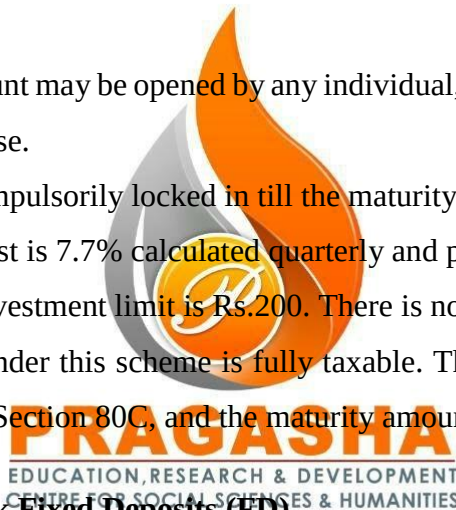
- An individual aged 60 years or more is allowed to open the account. An individual of the age of 55 years or more but less than 60 years, who has retired under VRS (Voluntary Retirement Scheme) is also permitted to open account if he/she satisfies two conditions. First, the account is opened within one month of receipt of retirement benefits. Second, the investment amount should not exceed the amount of retirement benefits. The cut off age of 60 is on the date of investment.
- The maturity period of SCSS is five years. The account can be extended for three more years after maturity. Premature withdrawal after one year is allowed on deduction of an amount equal to 1.5% of the deposit and after two years by deducting 1% of the deposit. Hence, early withdrawal is not advisable as the loss is quite high.

- Interest rate offered is 8.4% per annum which is paid on quarterly basis. SCSS offers the highest rate of return in the safe investment category and has been specifically designed for the benefit of senior citizens.
- The minimum and maximum investment limits are Rs.1,000 and Rs.15 lakh, respectively. The senior citizen cannot invest in a single name above Rs.15 lakh.
- Interest income is taxable, and taxes will be deducted at source if it is more than Rs.10,000 p.a. Maturity amount is exempt from tax.

5 Year Post Office Time Deposit (POTD)

This POTD can be opened with any of the post office branches near you and only basic KYC is required for opening a POTD account. The following are some of the key features of the 5-year POTD:

- This POTD account may be opened by any individual, and there are no restrictions of age or otherwise.
- The POTD is compulsorily locked in till the maturity period of five years
- The rate of interest is 7.7% calculated quarterly and payable annually.
- The minimum investment limit is Rs.200. There is no upper limit to investment.
- Interest earned under this scheme is fully taxable. The investment is eligible for deduction under Section 80C, and the maturity amount is exempt from tax.



5-year Tax Saving Bank Fixed Deposits (FD)

This is just like any other Bank FD except that it has a five year compulsory lock-in period. These bank FDs were recently added to the list of eligible investments under the Section 80C category. Here are some key highlights that you need to know...

- All resident individuals can open an account. Senior citizens above the age of 60 years are also eligible to open a tax saver fixed deposit account.
- The maturity period is five years, and unlike normal bank FDs, a person cannot liquidate this FD before the completion of five years.
- The interest rates vary from time to time. Since there is a compulsory lock-in period of five years, the rate of interest offered will be higher than your normal 1-year and 2-year FDs.

- The minimum investment limit is Rs.1000. There is really no upper limit for investment, of course, your overall limit under Section 80C will still be governed by the outer umbrella limit of Rs.1.50 lakh.
- Interest income is taxable on maturity. The investment qualifies for deduction under 80C and maturity amount is exempt from tax. The interest income will be added to your total income and taxed at your extant rates of tax.

Unit Linked Insurance Plan (ULIP)

Among the various categories of instruments that are eligible for tax exemption under Section 80C, this has been one of the most controversial among them. This is largely because this ULIP product is a combination of investment and insurance, and hence, has been vulnerable to mis-selling. In a ULIP, a portion of the money invested will be used to provide risk cover and the balance amount will be invested in the stock market. However, investors need to be cautious here that ULIPs have very high loading, and hence, it will be only profitable if held for a period of more than 8-10 years, irrespective of the shorter lock-in period of just five years. Here are some key features of the ULIP.

- An investor can buy a ULIP for self, spouse, or a child. The child can be married or unmarried, dependent or independent, and minor or major.
- Partial withdrawals are allowed after five years. However, for a ULIP to be really profitable after considering the initial loading costs, it takes a minimum of 8-10 years to be profitable. Like ELSS, the returns on the ULIP are also market-linked and there are no assured returns on this.
- There are no upper limits for investing in ULIPs but the deduction under Section 80C will be allowed only up to Rs.1.50 lakh every financial year.
- Investment, withdrawals, and maturity amount are tax-free. The investments qualify for Section 80C, while withdrawals are entirely tax free, as is the redemption.

Illustration 1: Comparing Section 80C investment options

Investments	Rate of Return	Lock-in Period	Assured Returns	Risk-Profi

ELSS	Market-linked	3 yrs	No	High Risk
EPF	8.65%	5-15 yrs	Yes	Low Risk
PPF	7.9%	5-15 yrs	Yes	Low Risk
NSC	7.9% for 5 year	5 yrs	Yes	Low Risk
5-year FD	Varies from time time (7% SBI)	5 yrs	Yes	Low Risk
5-year POTD	Varies from time time (Currently 7.7%)	5 yrs	Yes	Low Risk
ULIP	Market-linked	5 yrs	No	High Risk
Sukanya Samriddhi Scheme	8.4%	21 yrs	Yes	Low Risk
SCSS	8.4%	5 yrs	Yes	Low Risk

Please note that above rates of return are just indicative and are subject to modifications from time to time

Miscellaneous list of Section 80C deductions



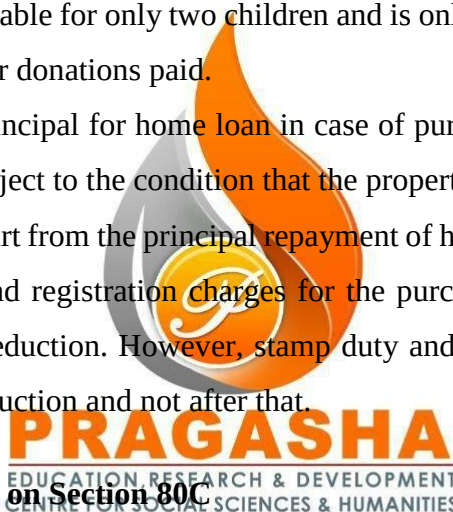
Apart from the abovementioned popular methods of investing in Section 80C investments, there is an added benefit of other such eligible investments. These are not available on tap, but institutions come out with such issues from time to time. They include Infrastructure Bonds issued by Infrastructure companies IDFC and IIFC. In addition, Rural Bonds issued by NABARD (National Bank for Agriculture and Rural Development) are also eligible.

SECTION 2 – ELIGIBLE EXPENSES UNDER SECTION 80C OF THE INCOME TAX ACT

Apart from investments, certain expenses are also eligible for the benefit under Section 80C. Three such key sub-headers under eligible expenses for Section 80C benefit include

Life Insurance Premium, Tuition Fees of children, and Home loan principal repayment. Let us look at these in detail...

- Life Insurance Premium is an expense and not an investment. It is paid by the individual to secure his/her dependents in the event of any unforeseen event. Life insurance cover is available as a protection against the death of an individual. While returns on insurance can be calculated for endowment plans (ranges from 4.5 to 5.5%), there are no returns earned on term policies. However, the 80C benefit is available for endowment plans, money back plans, whole life plans, and term plans.
- In the early 2000s, the benefit of Section 80C was also extended to the payment of Children's Tuition Fees provided the school was located within India. This deduction is available for only two children and is only for tuition fees and not for any capital fees or donations paid.
- Repayment of principal for home loan in case of purchase of property is eligible for deduction subject to the condition that the property is not sold within a period of five years. Apart from the principal repayment of home loan, expenses incurred on stamp duty and registration charges for the purchase of house property also qualify for tax deduction. However, stamp duty and registration only qualify in the year of construction and not after that.



Final concluding points on Section 80C

- All exemptions under Section 80C have to be backed by documentary proof.
- NPS initiated by the Government of India gives an additional amount of Rs.50,000 u/s 80CCD (1B) which is over and above the limit of Rs.1.50 lakhs under Section 80C.
- NRIs can also claim tax benefits under Section 80C.

Section 80D of Income Tax Act

Medical costs have been shooting through the roof in India in the last few years. A casual visit to the hospital for a couple of days can set you back by nearly Rs30,000 depending on the gravity of your ailment. Complex surgeries run into multiples of lakhs, and there is no way most people can afford funding them through their own resources. The answer

lies in medical insurance or health insurance. A health insurance provides you cover against hospitalization expenses and includes costs of tests, room rent, the actual cost of surgery, cost of treatment as well as other medicines and disposables used during hospitalization.

The advantage of buying health insurance is not only that it gives the much needed cover against hospitalization costs but also provides tax benefits under Section 80D of the Income Tax Act. Section 80D is in the form of an exemption, and so, the contribution is deducted from the total taxable income. Therefore, the tax shield that Section 80D provides is equivalent to 31.2% (30% tax + 4% cess) of the contribution. Effectively, if you pay medical insurance premium of Rs10,000 during the year, your effective cost of the insurance after considering the tax shield will be only Rs6,880 after adjusting for the 31.2% tax shield.

Section 80D for Mediciam Premium to Individual, HUF, Senior Citizens

Under Section 80D with respect to Medical Insurance Premium (Mediciam) paid by an individual either for himself or for a spouse, parents, and dependent children or Hindu Undivided Family (HUF) is available as an exemption from total taxable income. A Mediciam policy is a must because should you fall sick or meet with an accident, your medical bills could wipe out your savings. Mediciam premiums can be paid annually. However, insurance companies also offer the facility of paying premium for two years at once. In that case, you can split the tax exemption under Section 80D across two years.

One more thing to remember here is that the benefit of Section 80D is only available when such policies are purchased from IRDA-authorized non-life insurance companies in India. Mediciam premium benefits are available only when the individual assessee pays out the premium from his/her taxable salary. Therefore, any premiums paid for an employee by the employer will not entitle the employee to claim any tax benefits as the premium is not paid by him/her.

What are the salient features of a health insurance (Mediciam Policy)

How are premiums of Mediciam policy determined?

As in term insurance, the premium rates will vary across insurers and will also depend on your age. The older you are, the heavier the premium. That is why, it is always recommended to take health insurance as early as possible. The premium will also vary depending on pre-existing diseases or the vulnerability of the individual to such diseases. It is possible even for people with health problems like hypertension and diabetes to get a Medisave health policy, although the premiums will be higher in this case.

Who can claim Deduction Under Section 80D of the Income Tax Act?

Every medical insurance policy has a sponsor who will be the main insured. A sponsor is the one who pays premium for the health insurance policy and the cover is taken on the individual health of family members. Only the person who issues the cheque for the premium can claim the deduction in case of Section 80D.

Health Insurance can be taken by an individual (resident or non resident, Indian Citizen or foreign citizen). In case an individual claims deduction, the medical insurance policy can be taken in the name of any one of the following: the taxpayer or the spouse, parents or dependent children* of the taxpayer. Hindu undivided Family (HUF) may be resident or non resident). In case an HUF claims the deduction, the medical insurance policy can be taken in the name of any member of the family.



Can any family member be covered under the Health Insurance Plan for Section 80D?

There are two parts to the Section 80D benefit under health insurance. First, the benefit is available for an insurance cover for self and family. Family here is defined as your spouse and your minor children, if applicable. Additionally, there is an extra exemption that can be claimed for taking medical insurance in the name of your parents; irrespective of whether they are dependent or not.

The focus is more on dependent children rather than on minor children. Children here include legitimate children and legally adopted children, but do not include illegitimate children. Children above 18 years, if employed, cannot be covered. Male children who are bonafide students can be covered up to age of 25 years, if not employed. Female children, if not employed, can be covered until the time they are married. Parents of an

individual can be covered irrespective of whether they are dependent on the assessee or not.

At what age is it possible to take medical insurance [Why caps?]in India?

Medical insurance (health insurance) is available to a person between the ages of 18 and 59 years. However, an existing Policy can be renewed up to the age of 80 years if the person has been continuously paying premiums for a minimum period of 5 years. In some special cases, insurance companies also permit increasing the limit to 90 years with conditional premium stipulations. Normally, any person taking a medical policy after the age of 46 is required to go through a comprehensive medical test before the policy is issued to them. It needs to be noted that this only pertains to the sponsor of the health insurance policy who is claiming tax benefits under Section 80D. It does not pertain to persons covered by the policy.

Who can be covered by medical insurance policy?

Children above the age of three months can be covered, provided parents are covered concurrently and suitable premium is paid. If the child above 18 years is employed or if the girl child is married, he or she shall cease to be covered under the policy. However, a male child can be covered up to the age of 25 years if he is a bona fide regular student and fully dependent on primary insured. Female child can be covered only up to the time of her marriage.

Once the policy is taken, no inclusion of family member during currency of policy is permissible except for a newborn child between the ages of 3 months to 6 months and newly married spouse within 60 days of marriage. Otherwise, inclusion of a family member shall be allowed only at the time of renewal. Prorata premium shall be charged for such additional inclusion during the currency of the policy for the unexpired period.

What is the maximum sum insured permissible?

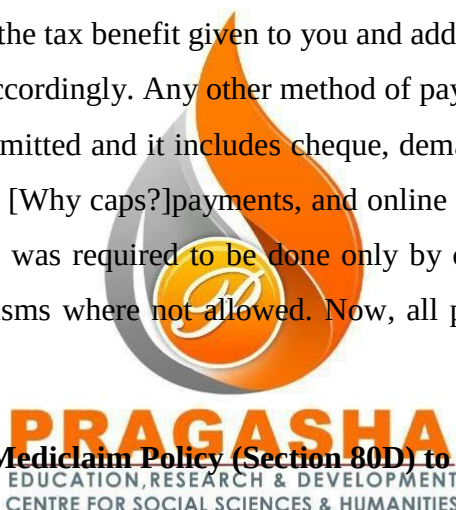
The minimum sum insured shall be Rs50,000 and can be increased in multiples of Rs25,000 up to Rs5 lakh. The sum insured must be identical for the primary insured and dependents. However, the children may be covered for 50% sum insured. Alternatively,

nowadays there are also floaters which come with a comprehensive family cover and the overall limit can be shared by the family members who are named in the policy document.

For the Section 80D benefit, premium must be paid out of taxable income only.

The amount must have been paid using the taxpayer's income chargeable to tax. It needs to be noted that the Section 80D benefit is in addition to the Section 80C limit of Rs1.50 lakh. If part payment is done by you and part payment by the parent, both can claim deduction under Section 80D to the extent of their contribution subject to the maximum amount allowed, but the premium should be paid directly to the insurance company through modes other than cash.

If the payment for premium under Section 80D is made by cash, income tax authorities have the right to reverse the tax benefit given to you and add it back to your total income and recalculate the tax accordingly. Any other method of payment of premium that has a banking audit trail is permitted and it includes cheque, demand draft, pay order, NEFT, RTGS, IMPS, debit card [Why caps?] payments, and online payments. Prior to 1st April 2009, premium payment was required to be done only by cheque. Credit card or other online payment mechanisms were not allowed. Now, all payment modes except cash payments are accepted.



Additional features of Mediclaim Policy (Section 80D) to be aware of

The Section 80D benefit is only available to policies that are approved and regulated by the Insurance Regulatory Authority of India (IRDA), which is the central regulatory body for all life and non-life insurance businesses in India. Mediclaim premium paid under the medical insurance scheme of General Insurance Corporation approved by the Central Government or any other insurer approved by the Insurance Regulatory & Development Authority (IRDA) are, therefore, eligible.

The premium is to be paid to keep in force the insurance policy, there is no condition that the assessee should be the proposer of the policy. However, the benefit of Section 80D is only available against the proof of actual premium payment and not on the premium accrued. Thus, documentary proofs (either online or offline) are a must.

How much deduction is available under Section 80D of the Income Tax Act?

- Basic deduction under Section 80D for Medici claim premium paid for self, spouse, or dependent children is subject to a maximum deduction Rs25,000. Here, it is assumed that the principal policy holder is under the age of 60.
- In case any of the persons specified above is a senior citizen (i.e., 60 years or more) and Medici claim Insurance premium is paid for such a citizen, deduction amount is Rs50,000/- from AY2019-20. This amount used to be Rs30,000 till the AY2018-19.
- For uninsured super senior citizens (more than 80 years old) & senior citizens (i.e., 60 years or more), medical expenditure incurred up to Rs50,000 (effective from AY2019-20) will be allowed as a deduction under section 80D.
- Apart from the premium paid for self and family, there is an additional provision available to insure the health of your parents. This is irrespective of whether your parents are dependent on you[redundant]. Additional deduction under Section 80D: Medici claim premium paid for parents is available to the tune of Rs50,000 from AY2019-20.
- Medici claim premium paid for any member of the HUF: Maximum deduction under Section 80D Rs25,000. In case any member of the HUF covered by the Medici claim policy is a senior citizen, deduction under Section 80D amount is enhanced to Rs30,000 (it has been increased to Rs50,000 from AY2019-20).



Illustration 1:

Here is how the specific tax benefits of Section 80D can be captured in the form of a single comprehensive table.

Section 80D Scenarios	Benefit of Section 80D for self and family	Benefit of Section 80D for parents policy	Total benefit under Section 80D
Scenario 1: (The main insured is below 60 and his/her parents are also below the age of 60)	Rs25,000 premium is eligible for deduction	Rs25,000 premium is eligible for deduction	Total deduction Rs50,000 is available under Section 80D

Scenario 2: (The main insured is below 60 and his/her parents are above the age of 60)	Rs25,000 premium is eligible for deduction	Rs50,000 premium is eligible for deduction	Total deduction Rs75,000 is available under Section 80D
Scenario 3: (The main insured is below 60 and his/her parents are above the age of 80)	Rs25,000 premium is eligible for deduction	Rs50,000 premium is eligible for deduction	Total deduction Rs75,000 is available under Section 80D
Scenario 4: (The main insured is above 60 and his/her parents are above the age of 80)	Rs50,000 premium is eligible for deduction	Rs50,000 premium is eligible for deduction	Total deduction Rs1,00,000 is available under Section 80D

As the above table depicts, Section 80D can proffer a maximum tax exemption of Rs1lakh if the benefits of self and parents are considered in an extreme scenario. The effective tax shield will be 31.2% of the exempted amount in each of the cases.

Let us now look at the nuances of the medical insurance premium payment for tax purposes under Section 80D of the Income Tax Act.

Illustration 2:



Rakesh Mehta (assessee) pays (through any mode other than cash) medical insurance premiums for himself and family during the previous year out of his taxable income as follows:

- Rs23,000/- to keep in force an insurance policy on his health and on the health of his wife and dependent children
- Rs32,000/- to keep in force an insurance policy on the health of his parents who are 54 and 58 years of age[?]. He has also paid medical insurance premium on behalf of his wife's uncle to the tune of Rs9,000. His wife's uncle is aged 66 years.

Rakesh Mehta will be allowed a deduction of Rs48,000/- (Rs23,000/- + Rs25,000/-) since neither of his parents is a senior citizen.

However, any premium paid on behalf of his wife's uncle will not entitle Rakesh to any tax benefit under Section 80D, given that this facility is only available in case of a spouse, minor/dependent children, and one's own parents. Thus, the Rs9,000 paid as premium by Rajesh on the health insurance of his wife's uncle will not entitle him to any tax benefit under Section 80D of the Income Tax Act.

Illustration 3:

In Illustration 2, Rajesh Mehta has paid a premium of Rs55,000 for the medical insurance cover of self, family, and parents. Let us assume that his own premium was paid by Pay Order, whereas the medical insurance premium on the health of his parents was paid in cash as it was already the last day. What happens in that case?

In the above case, he would get the full benefit of Rs23,000 on the medical cover for self and family as the amount was paid by cheque. However, in the case of his parents' insurance, Rajesh will lose the Section 80D tax benefit since the amount was paid by cash rather than by cheque. Needless to say, the insurance cover on the health of Rakesh's parents will continue as before. However, the tax deduction on the premium paid on the health of parents will not be available to Rajesh since the payment was made in cash. Section 80D stipulates any mode other than cash and includes cheque/demand draft/pay order/NEFT transfer/RTGS/Debit Card/Credit Card/IMPS/UPI etc.

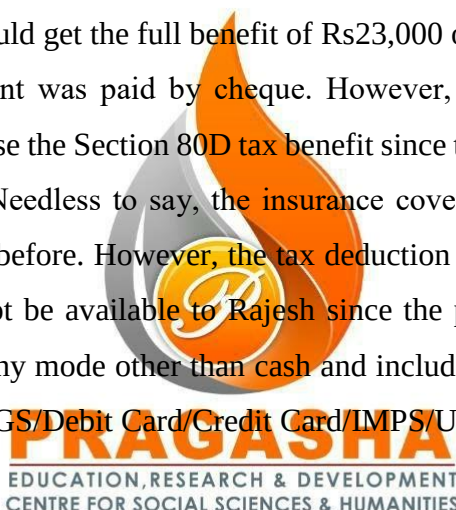


Illustration 4:

An individual assessee pays health insurance premium through credit card during the previous year as under:

- a. Rs.21,000 to keep in force an insurance policy on his health and on the health of his wife and children
- b. Rs40,000 to keep in force an insurance policy on the health of his parents.

While his mother is 58 years of age, his father is 63 years of age. This means that while his father is a senior citizen, his mother is technically not a senior citizen. So, should the person get benefit of senior citizens for his parents or only Rs25,000 because his mother is not a senior citizen? Under the new provisions, he will be allowed a deduction of

Rs61,000 (Rs21,000 + Rs40,000) because one of his parents is a senior citizen, which is good enough to meet this condition. The rule only states that if any of his parents is a senior citizen, he will be allowed a deduction of Rs50,000 (from AY 2019-20) or the actual premium paid (whichever is lower). Whether the parents are dependent or not is not a consideration for deciding the deduction under Section 80D.

Please note the modified provision to the relevant case with effect from FY2018-19 corresponding to AY2019-20

Under the new provisions, he will be allowed a maximum deduction of Rs25,000 on his family's cover and Rs50,000 on his parents health cover even if one of them is a senior citizen above the age of 60. Union Budget 2018 has virtually scrapped the distinction between a senior citizen and a super senior citizen (above the age of 80) and extended more liberal benefits to both these categories of people. Again, in this case, whether the parents are dependent or not is not a consideration for deciding the deduction under Section 80D.

Illustration 5:

Ms. Sheetal Pawar who is 61 years of age has made the following payments during the FY2018-19 corresponding to AY2019-20:

- 
- PRAGASHA**
EDUCATION, RESEARCH & DEVELOPMENT
CENTRE FOR SOCIAL SCIENCES & HUMANITIES
- Medical insurance premium on her medical cover policy from New India Assurance of Rs21,000.
 - Medical insurance premium on policy of her husband Lalit Pawar of Rs23,000.
 - Medical insurance premium on policy of her 30-year old daughter of Rs11,000. Sheetal's daughter is currently employed with an airline company
 - Medical insurance premium on policy of her adopted son of Rs9,000 per year, who is 16 years old and studying in junior college.
 - Payment of medical insurance premium on policy of her parents (resident and aged 84 and 88 years), Rs27,000 on policy of father and Rs25,000 on policy of mother. Both are dependent on Sheetal's brother as of now.

How much of tax deduction can Sheetal Pawar claim under Section 80D of the Income Tax Act?

What will qualify for deduction (item-wise)?

- Medical insurance premium on her medical cover policy from New India Assurance of Rs21,000. (This will qualify for exemption under Section 80D)
- Medical insurance premium on policy of her husband Lalit Pawar of Rs23,000. (This will also qualify for exemption under Section 80D)
- Medical insurance premium on policy of her 30 year old daughter of Rs11,000. Sheetal's daughter is currently employed as an Air Hostess with Indigo Airlines. (This will not qualify for exemption under Section 80D as her daughter is an adult and also independent)
- Medical insurance premium on policy of her adopted son of Rs9,000 per year who is 16 years old and studying in junior college. (This will qualify for exemption under Section 80D)
- Payment of medical insurance premium on policy of her parents (resident and aged 84 and 88 years), Rs27,000 on policy of father and Rs25,000 on policy of mother. Both are dependent on Sheetal's brother right now (This will qualify for exemption under Section 80D)

We can now tabulate the situation in the following table as under:

Contribution	Exemption U/S 80D for family	Exemption U/S 80D for parents	Total Exemption for Sheetal Pawar
Premium paid for Self	Rs21,000		
Premium paid for husband	Rs23,000		
Premium paid for independent daughter	Not Eligible		
Premium paid for dependent son	Rs9,000		
Premium paid for father		Rs27,000	
Premium paid for mother		Rs25,000	
Total eligible premium	Rs53,000	Rs52,000	

Subject to maximum limit of	Rs.50,000	Rs.50,000	Rs.1,00,000

In the above case, since Sheetal is also a senior citizen, she is entitled to a maximum Section 80D benefit up to Rs50,000 for her family and Rs50,000 for her parents taking the total benefit to Rs1 lakh.

Medical insurance is a sunk cost and the premium paid is your cost each year. However, considering the rising medical costs and the tax benefits proffered by the Income Tax Act, it surely adds value to tax payers.

Section 80G Of The Income Tax Act

If charity begins at home, Section 80G of the Income Tax Act is the government's way of recognizing your good work. Doing charity is a noble task, which is why even the tax department acknowledges this fact. The Income Tax Act clearly defines the list of donations that are eligible for exemption from your income and these are covered under Section 80G of the Income Tax Act. Section 80G of the Income Tax Act offers a tax deduction on contributions made to certain charitable institutions prescribed under the Income Tax Act, 1961.

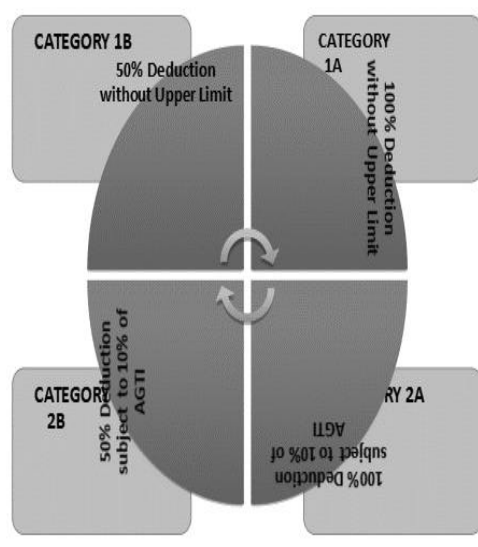
Who can contribute and how to contribute?



Unlike many other sections of the Income Tax Act, Section 80G can be availed by any category of tax payer, and it need not necessarily be an individual only. In fact, any taxpayer can claim this tax deduction for making donations as long as these donations are made towards an approved charitable institution, as clearly spelt out in Section 80G of the Income Tax Act and modified from time to time through appropriate circulars.

This brings us to the next question; how can these donations be made towards Section 80G charitable institutions? In fact, only donations made in the form of cash or cheque are eligible for tax deduction. However, donations made in cash do not qualify for a tax deduction exceeding Rs2,000 in any financial year. This limit used to be Rs10,000 for cash payments till the end of financial year 2016-17. However, post the digitization thrust taken up by demonetization, the Income Tax Act further reduced this eligible cash donation to Rs2,000 per fiscal year. If your overall donation includes a cash component

of more than Rs2,000, then that portion in excess of Rs2,000 will not qualify for Section 80G deduction. Any permitted non-cash payment is eligible for deduction under Section 80G and includes payment via cheque/demand draft/pay order/NEFT/RTGS/IMPS/Debit Card/UPI, etc., where there is a clear banking trail of funds.



4 categories of exemptions available under Section 80G of the Income Tax Act

The Income Tax Act has broadly classified the Section 80G Exemption Benefits into 4 broad categories based on their eligibility for exemption. While we shall look at the specific items included in each category later in this chapter, let us under these categories first.

- Category 1A: Where deduction is available without any upper limit. These charity institutions/schemes qualify for 100% exemption on the contribution made during the financial year. The total exemption under this category will be restricted to the taxable income in all cases. You cannot report a loss after deducting Section 80G benefits, nor can you carry forward any loss to future years. This exemption is only permitted to the extent of your total taxable income.
- Category 1B: Where deduction is available without any upper limit. However, these charity institutions/schemes qualify for 50% exemption on the actual contribution made during the financial year. Again, the total exemption under this category will be restricted to the taxable income in all cases. You cannot report a loss after deducting

these Section 80G benefits, nor can you carry forward any loss to future years. This exemption is only permitted to the extent of your total taxable income.

- Category 2A: Where deduction is subject to a maximum limit of 10% of Adjusted Gross Total Income and donations are eligible for 100% exemption for your contribution, but for the purpose of tax calculation, the total exemption claimed cannot exceed 10% of Adjusted Gross Total Income. We shall see later in this chapter how Adjusted Gross Total Income (AGTI) is calculated.
- Category 2B: Where deduction is subject to a maximum limit of 10% of Adjusted Gross Total Income and donations are eligible for 50% exemption for your contribution, but for the purpose of tax calculation, the total exemption claimed cannot exceed 10% of Adjusted Gross Total Income.

Before we get into the above 4 categories of Section 80G exemptions, let us first understand the key documents that are required for the purpose of claiming Section 80G benefits under the Income Tax Act.

Documentation required for claiming deduction under Section 80G of the Income Tax Act

The following documents are important to claim tax exemption under Section 80G of the Income Tax Act. It is always better to ensure that documentation is in place as it will ensure that claims do not get rejected by the Income Tax Department or you do not get any queries from the department. An important point to remember here! If you are employed with an organization, the HR department normally does not accept Section 80G proofs for the purpose of Tax Deduction at Source (TDS). The HR department will deduct tax assuming that Section 80G contributions were not made. The onus is on the assessee to subsequently include the details of Section 80G in the Income Tax Returns and claim refund from the Income Tax Department.

Here are some of the key documents that are essential for claiming benefits under Section 80G of the Income Tax Act.

Stamped receipt:

For claiming deduction under Section 80G, a receipt issued by the recipient trust is a must. The receipt must contain the name, address & PAN of the Trust, the name of the donor, and the amount donated (it must be ensured that the amount written in words and figures tally). In case of donations which are eligible for 100% deduction, the assessee must also insist on Form 58 from the trust. Form 58 clearly lays out the details of project cost (for which the donation is received), amount authorized under this project, and the actual amount collected. Without Form 58, the claim for 100% deduction could be rejected even if the receipt mentions 100% deduction.

Section 80G Registration Numbers of the Trust on receipt:

Registered trusts are assigned a unique Registration Number which makes them eligible as authorized Section 80G trusts. The Registration number issued by the Income Tax Department under Section 80G must be clearly printed on the receipt. Generally, the Income Tax Department issues the registration for a limited period (of 2 years) only. Thereafter, the registration has to be renewed. The receipt must not only mention the Registration number but also the validity period of the registration and the date of expiry of the registration. The assessee must also check these details before making the contribution.

Check validity of Registration under Section 80G on date of Donation:

The donor must ensure that the registration is valid on the date on which the donation is given. For example, the registration of a trust may be valid from April 1, 2007 to March 31, 2009. Now, if the trust does not get its registration renewed on or after April 1, 2009, even if a donation receipt is issued by the trust to the donor for donations received on or after April 1, 2009, the donor would not get any tax benefit. This rule has been slightly modified for the sake of simplicity. Registrations are now deemed to be valid unless the Income Tax Department specifically asks the trust to apply for renewal. The following dates are important. With effect from 1st October, 2009, a trust need not apply for the renewal of 80G certificate, if the same is valid on 01.10.2009 or valid up to a date thereafter, unless the Department specifically asks the trust to apply for renewal. This means that the old 80G certificate will remain valid if the same is valid on 01.10.2009.

Photocopy of Section 80G Certificates:

Check the validity period of the 80G certificate. Always insist on a photocopy of the 80G certificate in addition to the receipt. However, this document is not mandatory to claim tax deduction. You can ask for a photocopy of this certificate to ensure that it is still valid.

Maximum Deduction limit under section 80G

As laid out earlier in this chapter, some donations qualify for either 50% or 100% tax deduction irrespective of the amount of contribution, whereas some others qualify for the same deduction but up to a maximum limit of 10% of Adjusted Gross Total Income (AGTI) of the taxpayer only. So, broadly they can be divided into 4 categories as under:

- Category 1A: Where deduction is available without any upper limit up to 100% of the contribution made.
- Category 1B: Where deduction is available without any upper limit but subject to 50% exemption on the actual contribution made
- Category 2A: Where deduction of 100% exemption is available subject to a maximum limit of 10% of Adjusted Gross Total Income
- Category 2B: Where deduction of 50% exemption is available subject to a maximum limit of 10% of Adjusted Gross Total Income

However, in cases of Category 1A and Category 1B, the total exemption claimed under Section 80G cannot, under any circumstances, exceed the taxable income. There is no concept of declaring a loss after providing for Section 80G or for carrying forward any losses due to Section 80G exemptions.

Understanding the concept of Adjusted Gross Total Income?

Before getting into the specifics of the categories of Section 80G, let us understand what Adjusted Gross Total Income (AGTI) actually means and how it is calculated.

Adjustment	Particulars of the Tax Head	Amount
	Gross Total Income	1,000
	Less: Long Term Capital Gains	100
	Less: Short Term Capital Gains u/s 111A	180

	Less: Deductions u/s 80C to 80U (except 80G)	90
	Less: All exempt incomes	100
	Less: Income referred to Section 115A to 115D	-
	Adjusted Gross Total Income	530
	Less: Deduction under Section 80G	120
	Total Taxable Income	410

The above definition of Adjusted Gross Total Income (AGTI) is what is used for the actual classification of the Section 80G contribution. Let us now look at the specific contributions laid down by the Income Tax Act for each of these categories.

Category 1A: Section 80G deduction available without any upper limit up to 100% of the contribution made.

- 
- National Illness Assistance Fund
 - National Blood Transfusion Council or to any State Blood Transfusion Council
 - National Defence Fund set up by the Central Government
 - Prime Minister's National Relief Fund
 - National Foundation for Communal Harmony
 - Zila Saksharta Samiti constituted in any district under the chairmanship of the Collector of that district
 - Fund set up by a State Government for the medical relief to the poor
 - National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation, and Multiple Disabilities
 - An approved university/educational institution of National eminence
 - National Sports Fund
 - National Cultural Fund
 - Fund for Technology Development and Application
 - National Children's Fund
 - Chief Minister's Relief Fund or Lieutenant Governor's Relief Fund with respect to any State or Union Territory

- The Army Central Welfare Fund or the Indian Naval Benevolent Fund or the Air Force Central Welfare Fund, Andhra Pradesh Chief Minister's Cyclone Relief Fund, 1996
- The Maharashtra Chief Minister's Relief Fund during October 1, 1993, and October 6, 1993
- Chief Minister's Earthquake Relief Fund, Maharashtra
- Any fund set up by the State Government of Gujarat exclusively for providing relief to the victims of earthquake in Gujarat
- Any trust, institution, or fund to which Section 80G(5C) applies for providing relief to the victims of earthquake in Gujarat (contribution made during January 26, 2001 and September 30, 2001)
- Prime Minister's Armenia Earthquake Relief Fund
- Africa (Public Contributions – India) Fund
- Swachh Bharat Kosh (applicable from FY 2014-15)
- Clean Ganga Fund (applicable from FY 2014-15)
- National Fund for Control of Drug Abuse (applicable from FY 2015-16)

The above contributions will qualify for 100% contribution without any upper limit on the claim. Of course, the benefit of Section 80G cannot exceed the total taxable income nor can it be carried forward to future assessment years.



Category 1B: Where deduction is available without any upper limit but subject to 50% exemption on the actual contribution made

- Jawaharlal Nehru Memorial Fund
- Prime Minister's Drought Relief Fund
- Indira Gandhi Memorial Trust
- Rajiv Gandhi Foundation

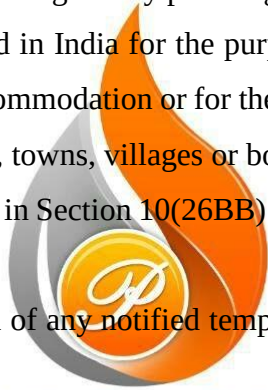
The above contributions will qualify for 50% contribution without any upper limit on the claim. Of course, the benefit of Section 80G cannot exceed the total taxable income, nor can it be carried forward to future assessment years.

Category 2A: Where deduction of 100% exemption is available subject to maximum limit of 10% of Adjusted Gross Total Income

- Government or any approved local authority, institution or association to be utilized for the purpose of promoting family planning.
- Donation by a Company to the Indian Olympic Association or to any other notified association or institution established in India for the development of infrastructure for sports and games in India or the sponsorship of sports and games in India.

Category 2B: Where deduction of 50% exemption is available subject to a maximum limit of 10% of Adjusted Gross Total Income

- Any other fund or any institution which satisfies conditions mentioned in Section 80G(5)
- Government or any local authority to be utilized for any charitable purpose other than the purpose of promoting family planning
- Any authority constituted in India for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns, villages or both
- Any corporation referred in Section 10(26BB) for promoting interest of a minority community
- For repairs or renovation of any notified temple, mosque, Gurudwara, church, or other places of worship



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Donations to political parties and other purposes

With the government permitting individuals to contribute to political parties, there is confusion as to whether the contribution to political parties also qualifies for tax benefit under Section 80G. While contributions to political parties do qualify for tax breaks, it is not under Section 80G. Political donations made to parties can be claimed under Section 80GGC offers tax deduction for donations made to political parties. Similarly, donations made for the purpose of Scientific Research entitle you to a deduction under Section 80GGA of the Income Tax Act. Further, there are occasions when your employer may contribute directly to a specific flood relief fund. In that case, a certificate of deduction from the employer is good enough for you to claim the Section 80G benefit.

Illustration 1:

Apoorva Shah contributed Rs50,000 to the National Defence Fund. His adjusted gross total income (AGTI) for the year is Rs4,25,000. How much deduction will Apoorva be entitled to under Section 80G of the Income Tax Act?

The National Defence Fund is a Category 1A contribution which qualifies the contributor for exemption up to 100% of the contribution without any other upper limit on the tax benefit. In this case, the AGTI will not be relevant for Apoorva and the entire amount of Rs50,000 will be exempt under Section 80G of the Income Tax Act.

Illustration 2:

Mayank contributed Rs25,000 to the National Children Fund. He paid Rs5,000 in cash, Rs10,000 in cheque, and Rs10,000 online on the web using his debit card. What will be his eligible exemption under Section 80G?

The National Children Fund is a contribution that entitles the contributor for 100% tax relief without any limitation. However, the Income Tax Act does not permit any donations under Section 80G to be made in cash beyond Rs2,000. Other modes of payment like cheque/DD/Debit Card/NEFT/IMPS are all permitted as they leave a banking audit trail. In the above case, Mayank will get an exemption for the full contribution made in cheque and by debit card. However, on his cash portion, he will only get exemption for Rs2,000 and the balance Rs3,000 will not entitle him to any exemption. Thus Mayank's total exemption in this case will be Rs22,000 (10,000 by cheque + 10,000 by Debit Card + 2,000 limits on cash).

Illustration 3:

Radhika contributes the following amounts for Section 80G benefit claims to reduce her taxable income:

National Defence Fund – Rs10,000

Rajiv Gandhi Foundation – Rs8,000

Contribution to notified Maharashtra Sports Association – Rs25,000

Contribution to repairs of local notified temple – Rs6,000

Radhika's adjusted gross total income (AGTI) for the year is Rs2,20,000. What is the total exemption she can get under Section 80G?

To calculate Radhika's actual exemption eligible for Section 80G, we need to first put each of these contributions into appropriate brackets.

- National Defence Fund is a Category 1A contribution with 100% exemption without any upper limit. Hence, the entire Rs10,000 contributed by her will be exempt.
- Rajiv Gandhi Foundation is a Category 1B contribution with 50% exemption without any upper limit. Hence, 50% of her contribution, i.e., Rs4000 will be eligible for exemption.
- Maharashtra Sports Association is eligible for exemptions as a Category 2A institution. Hence 100% of the contribution will be eligible, but subject to 10% of AGTI. Since her AGTI is Rs2,20,000, her exemption will be limited to Rs22,000, although her actual contribution is higher.
- Contribution to notified temple repairs being a Category 2B contribution makes her eligible to 50% deduction subject to an upper limit of 10% of AGTI. So, 50% of her contribution of Rs6000 will be eligible for exemption, i.e., Rs3,000

Thus, Radhika gets a total Section 80G exemption of Rs39,000 as above. This amount can be deducted from the AGTI to arrive at the taxable income of Radhika.



Illustration 4:

Rajesh Patel has an adjusted gross total income (AGTI) of Rs1,45,000. During the year he had made a total contribution of Rs1,60,000 towards the National Defence Fund from his previous savings. What is the Section 80G exemption that he can claim?

The question here is whether Rajesh Patel can take his income into negative territory and carry forward the loss. National Defence Fund is a Category 1A contribution, and hence, qualifies for 100% exemption without any outer limit. However, the condition is that the exemption under Section 80G cannot exceed the AGTI in any year, nor can such losses be carried forward. So, Rajesh Patel will only get exemption of Rs1,45,000 and his entire

income becomes tax-free. The additional contribution of Rs15,000 will not serve any purpose from a tax perspective.

Reference - <https://www.5paisa.com>

Set Off and Carry Forward of Losses

Set off of losses

Set off of losses means adjusting the losses against the profit/income of that particular year. Losses that are not set off against income in the same year, can be carried forward to the subsequent years for set off against income of those years. A set-off could be :

- a. An intra-head set-off
- b. An inter-head set-off

a. Intra-head Set Off

The losses from one source of income can be set off against income from another source under the same head of income.



For eg: Loss from Business A can be set off against profit from Business B where Business A is one source and Business B is another source and the common head of income is “Business”.

Exceptions to an intra-head set off:

- Losses from a Speculative business will only be set off against the profit of the speculative business. One cannot adjust the losses of speculative business with the income from any other business or profession.
- Loss from an activity of owning and maintaining race-horses will be set off only against the profit from an activity of owning and maintaining race-horses.
- Long-term capital loss will only be adjusted towards long-term capital gains. Interestingly, a short-term capital loss can be set off against long-term capital gain or short-term capital gain.

- Losses from a specified business will be set off only against profit of specified businesses. But the losses from any other businesses or profession can be set off against profits from the specified businesses.

b. Inter-head Set Off

After the intra-head adjustments, the taxpayers can set off remaining losses against income from other heads.

Eg. Loss from house property can be set off against salary income

Given below are few more such instances of an inter-head set off of losses:

1. Loss from House property can be set off against income under any head
2. Business loss other than speculative business can be set off against any head of income except income from salary.

One needs to also note that the following losses can't be set off against any other head of income:

a. Speculative Business loss

b. Specified business loss

c. Capital Losses

d. Losses from an activity of owning and maintaining race-horses

Carry forward of losses

After making the appropriate and permissible intra-head and inter-head adjustments, there could still be unadjusted losses. These unadjusted losses can be carried forward to future years for adjustments against income of these years. The rules as regards carry forward differ slightly for different heads of income. These have been discussed here:

Losses from House Property :



- Can be carry forward up to next 8 assessment years from the assessment year in which the loss was incurred
- Can be adjusted only against Income from house property
- Can be carried forward even if the return of income for the loss year is belatedly filed.

Losses from Non-speculative Business (regular business) loss :

- Can be carry forward up to next 8 assessment years from the assessment year in which the loss was incurred
- Can be adjusted only against Income from business or profession
- Not necessary to continue the business at the time of set off in future years
- Cannot be carried forward if the return is not filed within the original due date.

Speculative Business Loss :

- Can be carry forward up to next 4 assessment years from the assessment year in which the loss was incurred
- Can be adjusted only against Income from speculative business
- Cannot be carried forward if the return is not filed within the original due date.
- Not necessary to continue the business at the time of set off in future years

Specified Business Loss under 35AD :

- No time limit to carry forward the losses from the specified business under 35AD
- Not necessary to continue the business at the time of set off in future years
- Cannot be carried forward if the return is not filed within the original due date
- Can be adjusted only against Income from specified business under 35AD

Capital Losses :

- Can be carry forward up to next 8 assessment years from the assessment year in which the loss was incurred
- Long-term capital losses can be adjusted only against long-term capital gains.
- Short-term capital losses can be set off against long-term capital gains as well as short-term capital gains

- Cannot be carried forward if the return is not filed within the original due date

Losses from owning and maintaining race-horses :

- Can be carry forward up to next 4 assessment years from the assessment year in which the loss was incurred
- Cannot be carried forward if the return is not filed within the original due date
- Can only be set off against income from owning and maintaining race-horses only

Points to note:

1. A taxpayer incurring a loss from a source, income from which is otherwise exempt from tax, cannot set off these losses against profit from any taxable source of Income
2. Losses cannot be set off against casual income i.e. crossword puzzles, winning from lotteries, races, card games, betting etc.

What is the Due Date for Tax Filing? FY 2017-18, AY 2018-19

Latest Update

“The due date for filing returns for FY 2017-18 for businesses requiring tax audit and for companies has been further extended from 15 October 2018 to 31 October 2018. However, there is no extension of date for payment of taxes. Therefore, non payment before 30 September 2018 can result in interest under Section 234A.”

The due date for filing Income Tax Returns for FY 2017-2018 for Individuals was 31st August 2018. Refer the following table for finding due dates for the Financial Year 2017-2018:

Category of Taxpayer	Due Date for Tax Filing – FY 2017-18
Individual	August 31st, 2018
Body of Individuals (BOI)	August 31st, 2018
Hindu Undivided Family (HUF)	August 31st, 2018
Association of Persons (AOP)	August 31st, 2018
Businesses (Requiring Audit)	September 30th, 2018 (extended to 31st October 2018)

Businesses (Requiring TP Report) November 30th, 2018

(This is income tax return for the financial year 2017-18. Applicable for income earned from April 1st, 2017 to March 31st, 2018).

Important Due Dates of Income tax return filing for the year 2018 Whenever we talk about income tax, there is various kind of compulsory tax formalities that need to be followed by a person and that too within the specified due dates prescribed, such as filing of income tax returns, paying advance tax on time. **Here is the TAX CALENDAR for 2018.** This has important Tax Due and income tax return filing dates for the year 2018. **TAX CALENDAR 2018**

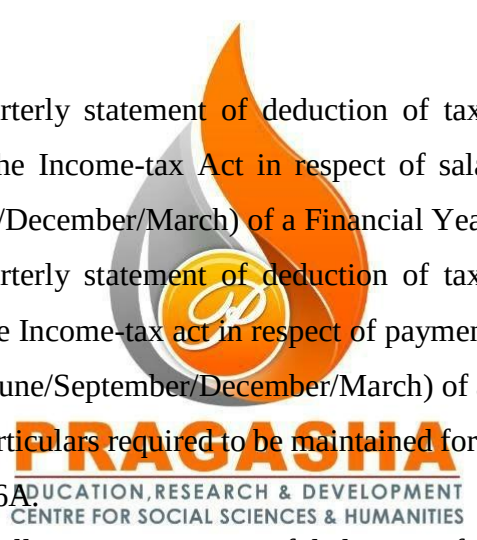
Due Date	Tax Due
15th March 2018	i. The fourth installment of Advance Tax due for the FY 2017-18 ii. The due date for the whole amount of Advance Tax for FY 2017-18 for taxpayers covered under the presumptive scheme of Section 44AD and 44ADA Read about how to calculate and pay Advance Tax.
15th June 2018	Due date for the First instalment of Advance Tax for the FY 2018-19
31st August 2018	Due date for filing Income tax return for FY 2017-18 for all persons except : i. Companies ii. Non-Companies whose books are required to be audited iii. Working partner of a firm whose accounts are required to be audited
15th September 2018	Due date for the Second instalment of Advance Tax for the FY 2018-19
30th September 2018 (extended to 31st October 2018)	Due date for filing of Audit report/Income tax return for the FY 2017-18 for the following: i. companies ii. Non-Companies Whose books are required to be audited
30th November 2018	i. The due date for filing Audit report for the FY 2017-18 in case of a person who is required to submit a report pertaining to international or specified domestic transactions under section 92E ii. The due date for the report to be furnished in Form 3CEB

	respect of international and specified domestic transactions in The due date for filing of Income-tax Return for FY 2017-18 for the aforesaid taxpayers
15th December 2018	The Due date for the third installment of Advance Tax for the FY 2018-19

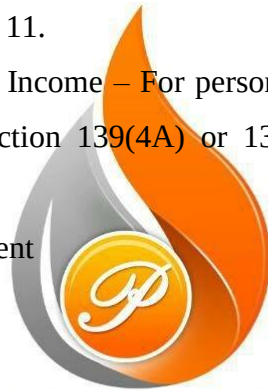
Further, here, it would be relevant to mention that if the due date for filing the original return of income is missed, one can file a return belatedly called a belated return for the FY 2017-18 on or before 31 March 2019.

Different Types of ITR Forms for F.Y. 2017-18

Income Tax Forms:

- 
- **Form 24Q**: Quarterly statement of deduction of tax under sub-section (3) of section 200 of the Income-tax Act in respect of salary for the quarter ending (June/September/December/March) of a Financial Year.
 - **Form 26Q**: Quarterly statement of deduction of tax under sub-section (3) of section 200 of the Income-tax Act in respect of payments other than salary for the quarter ending (June/September/December/March) of a Financial Year.
 - **Form 26QA**: Particulars required to be maintained for furnishing quarterly return under section 206A.
 - **Form 26QB**: Challan-cum-statement of deduction of tax under section 194-IA.
 - **Form 27Q**: Quarterly statement of deduction of tax under sub-section (3) of section 200 of the Income-tax Act in respect of payments other than salary made to non-residents for the quarter ending (June/September/December/March) of a Financial Year.
 - **Form 16**: Certificate under section 203 of the Income-tax Act, 1961 for TDS on salary.
 - **Form 16A**: Certificate under section 203 of the Income-tax Act, 1961 for TDS on income other than salary.
 - **Form 16B**: Certificate under section 203 of the Income-tax Act, 1961 for TDS on sale of property.

- **SAHAJ (ITR 1):** Return of Income - for individuals earning income from salary, pension, one house property, income from other sources and having total income upto Rs. 50 lakhs.
- **ITR-2 Form:** Return of Income - For Individuals and HUFs not carrying out business or profession under any proprietorship
- **ITR-3 Form:** Return of Income – For individuals and HUFs having income from a proprietary business or profession
- **ITR-4 Form:** Return of Income – For presumptive income from Business & Profession.
- **ITR-5 Form:** Return of Income – For persons other than, Individual; HUF; Company, and Person filing Form ITR-7
- **ITR-6 Form:** Return of Income – For companies other than companies claiming exemption under section 11.
- **ITR-7 Form:** Return of Income – For persons including companies required to furnish return under section 139(4A) or 139(4B) or 139(4C) or 139(4D) or 139(4E) or 139(4F).
- **ITR-V:** Acknowledgement



Meaning of Tax Planning

The avid goal of every taxpayer is to minimize his Tax Liability. To achieve the objective taxpayer may resort to following Three Methods :-

- Tax Planning
- Tax Avoidance
- Tax Evasion

It is well said that “Taxpayer is not expected to arrange his affairs in a such manner pay maximum tax “. So, the assessee shall arrange the affairs in a manner to reduce tax. But the question what method he opts for ? Tax Planning, Tax Avoidance, Tax Evasion !

Let us see its meaning and their difference.

5.1. MEANING OF TAX PLANNING

Tax Planning involves planning in order to avail all exemptions, deductions and rebates provided in Act. The Income Tax law itself provides for various methods for Tax Planning, Generally it is provided under exemptions u/s 10, deductions u/s 80C to 80D and rebates and reliefs. Some of the provisions are enumerated below :

- Investment in securities provided u/s 10(15) . Interest on such securities is fully exempt from tax.
- Exemptions u/s 10A, 10B, and 10BA
- Residential Status of the person
- Choice of accounting system
- Choice of organization.

For availing benefits, one should resort to bonafide means by complying with the provisions of law in letter and in spirit.

Where a person buys a machinery instead of hiring it, he is availing the benefit of depreciation. If it is his exclusive right either to buy or lease it . In the same manner, choice of the form of organization, capital structure, buy or make products are the assessee's exclusive right. One may look for various tax incentives in the above said transactions provided in this Act, for reduction of tax liability. All these transactions involve tax planning.



Why Every Person Needs Tax Planning ?

Tax Planning is resorted to maximize the cash inflow and minimize the cash outflow. Since Tax is kind of cost, the reduction of cost shall increase the profitability. Even a prudent person, to maximize the Return, shall increase the profits by resorting to what is known as Tax Planning.

How is Tool of Tax Planning Exercised ?

Tax Planning should be done by keeping in mind the following factors :

- The Planning should be done before the accrual of income. Any planning done after the accrual of income is known as Application of Income and it may lead to the conclusion that there is a fraud.

- Tax Planning should be resorted at the source of income.
- The Choice of an organization, i.e. Taxable Entity. Business may be done through a Proprietorship concern or Firm or through a Company.
- The choice of location of business , undertaking, or division also play a ve important role.
- Residential Status of a person. Therefore, a person should arranged his stay India such a way that he is treated as NR in India.
- Choice to Buy or Lease the Assets. Where the assets are bought, depreciation allowed and when asset is leased, lease rental is allowed as deduction.
- Capital Structure decision also plays a major role. Mixture of debt and equity fu should be balanced, to maximize the return on capital and minimize the t liability. Interest on debt is allowed as deduction whereas dividend on equity fu is not allowed as deduction

Methods Of Tax Planning

Various methods of Tax Planning may be classified as follows

1. **Short Term Tax Planning :** Short range Tax Planning means the planni thought of and executed at the end of the income year to reduce taxable income in a leg way.

Example : Suppose , at the end of the income year, an assessee finds his taxes have be too high in comparison with last year and he intends to reduce it. Now, he may do th to a great extent by making proper arrangements to get the maximum tax rebate u/s 8 Such plan does not involve any long term commitment, yet it results in substantial savin in tax.

2. **Long Term Tax Planning :** Long range tax planning means a plan chaled o at the beginning or the income year to be followed around the year. This type of planni does not help immediately as in the case of short range planning but is likely to help the long run ;

e.g. If an assessee transferred shares held by him to his minor son or spouse, thoug the income from such transferred shares will be clubbed with his income u/s 64, yet is t

income is invested by the son or spouse, then the income from such investment will be treated as income of the son or spouse. Moreover, if the company issues any bonus shares for the shares transferred, that will also be treated as income in the hands of the son or spouse.

3. **Permissive Tax Planning :** Permissive Tax Planning means making plans which are permissible under different provisions of the law, such as planning earning income covered by Sec.10, specially by Sec. 10(1), Planning of taking advantage of different incentives and deductions, planning for availing different tax concessions etc.

4. **Purposive Tax Planning :** It means making plans with specific purpose to ensure the availability of maximum benefits to the assessee through correct selection of investment, making suitable programme for replacement of assets, varying the residential status and diversifying business activities and income etc.

Tax Avoidance

It is an act of dodging tax without breaking the Law. It means when a taxpayer arranges his financial activities in such a manner that although it is within the four corners of the law but takes advantages of loopholes which exist in the Tax Law for reduction of tax liability. In other words though he has complied the letter of law but not the spirit behind the law.



Following transactions are held as Tax Avoidance which are :

1. Where tax law is complied with by using colorable devices which means that use of a dubious method or a method which is unfair for reduction of tax liability.
2. Where the facts of the case are presented in a false manner.
3. Where the spirit behind the law is avoided.
4. There is a malafide intention.

It means that method adopted for reducing tax liability should be within the framework of law. If it is not within the framework of law, it amounts to tax avoidance and not Tax planning.

Tax Evasion

Any illegal method which leads to reduction of tax liability is known as Tax Evasion. The Tax Evasion is resorted to by applying following dishonest means :

1. Concealing the Income
2. Claiming excessive expenditure
3. Falsification of accounts.
4. Willful violence of Rules

E.g. Claiming depreciation where no asset exist in the Business or claiming depreciation on the assets which is used for residential purposes. It Is basically fraudulent method of reduction in tax liability.

The Difference Between ‘Tax Planning’ And ‘Tax Management’

<i>Tax Planning</i>	<i>Tax Management</i>
(i) The Objective of Tax Planning is to minimize the tax liability	The objective of Tax Management is to comply with the provisions of Income Tax Law and allied rules.
(ii) Tax Planning also includes Tax Management	Tax Management deals with filing of Return on time, getting the accounts audited, deducting tax at source etc.
(iii) Tax Planning relates to future.	Tax Management relates to Past, Present, Future Past – Assessment Proceedings, Appeals, Revisions Present – Filing of Return, payment of advance tax etc. Future – To take corrective action
(iv) Tax Planning helps in minimizing Tax Liability in Short-Term and in Long-Term.	Tax Management helps in avoiding payment of interest, penalty, prosecution etc.
(v) Tax Planning is optional.	Tax Management is essential for every assessee

The Difference Between ‘Tax Avoidance’ And ‘Tax Evasion’

<i>TAX AVOIDANCE</i>	<i>TAX EVASION</i>
(i) Where the payment of tax is avoided through by complying with the provisions of law.	Where the payment of tax is avoided through illegal means or fraud is termed as tax evasion.

of law but defeating the intension of t law is known as tax Avoidance.	
(ii) Tax Avoidance is undertaken taking advantage of loop holes in law	Tax evasion is undertaken by employing unf means
(iii) Tax Avoidance is done through n malafied intention but complying t provision of law.	Tax Evasion is an unlawful way of paying t and defaulter may punished.
(iv) Tax Avoidance looks like a t planning and is done before the t liability arises.	Tax evasion is blatant fraud and is done after t tax liability has arisen.

Tax Consideration in Specific Business Decision viz.,

- make or buy
- own or lease
- retain or replace
- Export or Domestic Sales
- Shut-down or Closure
- Expand or Contract
- Invest or Disinvest



INDIRECT TAXATION

Meaning of Indirect Tax

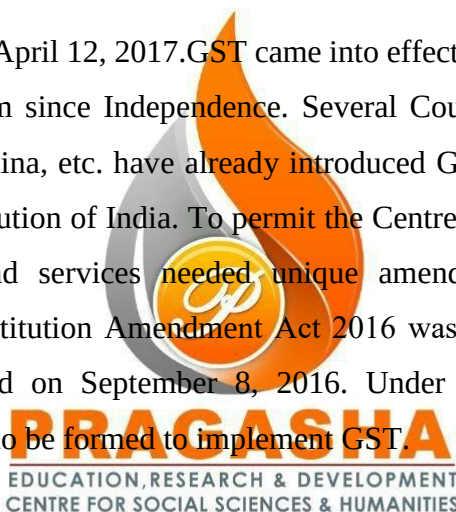
Indirect Tax is levied on the goods and services. It is collected from the buyers by the sellers and paid by the sellers to the Government. Since it is indirectly imposed on the buyers it is called indirect tax. e.g. GST - Goods and Services Tax, Excise duty. The following picture clearly explains the direct tax and indirect tax concepts.

Goods and Services Tax (GST) – Meaning

Goods and Services Tax (GST) is the tax imposed on the supply (consumption) of goods and services. It is a destination-based consumption tax and collected on those value-added items at each stage of the supply chain. A manufacturer in India, need not pay GST wherever he/she manufactures. GST is applicable to all goods and services except alcohol and specified petroleum products. GST Act has proposed four tax rates, i.e. 5%,12%, 18% and 28%. Traders having annual turnover, within state, below Rs.20 lakhs are exempted from GST. These small traders need not register under GST. But the traders having inter-state business should register and pay GST even the turnover is below Rs.20lakhs. Special provisions are there in the GST Act for the 8 north eastern states and Himachal Pradesh, Uttarakhand and Jammu and Kashmir.

Goods and Service Tax

GST Act was passed on April 12, 2017. GST came into effect from 1st July, 2017. It is the single biggest tax reform since Independence. Several Countries like Russia, Canada, Australia, Singapore, China, etc. have already introduced GST. The right to levy tax is derived from the Constitution of India. To permit the Centre and the States to levy taxes on the same goods and services needed unique amendment to the Constitution. Accordingly, 101st Constitution Amendment Act 2016 was passed and the President's acceptance was received on September 8, 2016. Under this Act, GST Council, a constitutional body was to be formed to implement GST.



Differences between Direct Taxes and Indirect Taxes

The main differences between direct taxes and indirect taxes are given in table.

Differences between Direct Taxes and Indirect Taxes

Basis	Direct Taxes	Indirect Taxes
1. Meaning	If a tax levied on the income or wealth of a person is paid by that person (or his office) directly to the Government, it is called direct tax.	If tax is levied on the goods or services of a person is collected from the buyers by another person (seller) and paid by him to the Government it is called indirect tax.
2. Incidence and Impact	Falls on the same person. Imposed on the income of a person and paid by the same person.	Falls on different persons. Imposed on the sellers but collected from the consumers and paid by sellers.
3. Burden	More income attracts more income tax. Tax burden is progressive on people.	Rate of tax is flat on all individuals. Therefore more income individuals pay less and lesser portion of their income as tax. Tax burden is regressive.
4. Evasion	Tax evasion is possible.	Tax evasion is more difficult
5. Inflation	Direct tax helps in reducing the inflation.	Indirect tax contributes to inflation.
6. Shiftability	Cannot be shifted to others	Can be shifted to others
7. Examples	Income Tax, Wealth Tax, Capital Gains Tax, Securities Transaction Tax, Perquisites Tax.	GST, Excise Duty.

Kinds of GST



Differences between CGST, SGST and IGST

	CGST	SGST	IGST
Meaning	CGST means Central goods and service tax to replace the existing tax like service tax, excise, etc. and It is levied by central government	SGST means State goods and service tax, replace the existing tax like sales tax, luxury tax, entry tax, etc. and it is levied by the state government	IGST refers to the Integrated Goods and Services Tax and it is a combined form of CGST and IGST and it is levied by central government
Collection of tax	Central government	State government	Central government
Applicability	Intra-state supply	Intra-state supply	Inter-state supply
Registration	No registration till the turnover crosses 20 lakhs (10 lakhs for north eastern states)	No registration till the turnover crosses 20 Lakhs (10 lakhs for north eastern states)	Registration is mandatory
Composition	The dealer can use the benefit up to 75 lakhs under the composition scheme	The dealer can use the benefit up to 75 lakhs under the composition scheme	The composition scheme is not applicable in interstate supply

GST is of three kinds: CGST, SGST/UGST, and IGST.



- a. **CGST** - Central Goods and Services Tax- imposed and collected by the Central Government on all supply of goods within a state (intra-state) under CGST Act 2017
- b. **SGST** - State Goods and Services Tax- imposed and collected by the State Governments under State GST Act. (Tamil Nadu GST Act 2017 passed by Tamil Nadu Govt.)
- c. **UGST** - Union Territory Goods and Services Tax - imposed and collected by the five Union Territory Administrations in India under UGST Act 2017.
- d. **IGST** - Inter-State Goods and Services Tax - imposed and collected by the Central Government and the revenue shared with States under IGST Act 2017.
- e. **IGST on exports** - All exports are treated as Inter-State supply under GST. Since exports are zero rated, GST is not imposed on all goods and services exported from India. Any input credit paid already on exports will be refunded.

GST Council

The GST Council will oversee the implementation of the GST. But the Central Board of Excise and Customs is responsible for administration of the CGST and IGST Acts. The Council makes recommendations on rate of GST, apportionment of IGST, exemptions, model GST laws, etc. The Chairman of the Council is the Union Finance Minister. The Minister of State in the Finance Ministry and all Finance Ministers of the State Governments shall be its members. The Central Governments shall have 1/3rd voting power and all State Governments shall have 2/3rd voting powers. All decisions of the Council can be passed only with 3/4th of the total votes. Each state has one vote, irrespective of its size or population. Twenty-four council meetings were held until 2017.

Apart from the GST Council, GST Secretariat was formed with the following officials

- i. The Secretary (Revenue) will be appointed as the Ex-officio Secretary to the GST Council.
- ii. The Chairperson, Central Board of Excise and Customs (CBEC), will be a permanent invitee (non-voting).
- iii. One post of Additional Secretary to the GST, and
- iv. Four posts of Commissioner in the GST Council Secretariat will also be created.

Objectives of GST

1. The foremost objective of GST is to create a common market with uniform tax rate in India. (One Nation, One Tax, One Market)
2. To eliminate the cascading effect of taxes, GST allows set-off of prior taxes for the same transactions as input tax credit.
3. To boost Indian exports, the GST already collected on the inputs will be refunded and thus there will be no tax on all exports.
4. To increase the tax base by bringing more number of tax payers and increase tax revenue.
5. To simplify tax return procedures through common forms and avoidance of visiting tax departments.
6. To provide online facilities for payment of taxes and submission of forms. Goods and Services Network (GSTN), a robust Information Technology system has been created for the operation of GST.

Benefits of GSTA. To the Society and country

1. Unified common national market will attract more foreign investment. GST has integrated the economy of all States and Union Territories.
2. It brings parity in taxation among imported goods and Indian manufactured goods. All imported goods will be charged with IGST which will be more or less equivalent to the total of CGST and SGST levied on manufactured goods. Removal of several taxes will make the price of Indian products more competitive at world market.
3. It will boost manufacturing, export, GDP leading to economic growth through increase in economic activity.
4. Creation of more employment opportunities which will result in poverty eradication.
5. It will bring more tax compliance (more tax payers) and increase revenue to the Governments.
6. It is transparent and will improve India's ranking in the 'Ease of Doing Business' in the world.
7. Uniform rates of tax will reduce tax evasion and rate arbitrage between States.

B. To Business Community

1. Simpler Tax System with fewer exemptions. 17 taxes were abolished and one tax exists today.
2. Input tax credit will reduce cascading effect of taxes. Reduction in average tax burden will encourage manufacturers and help “Make in India” campaign and make India as a manufacturing hub.
3. Common procedures, common classification of goods and services and timelines will lend greater certainty to taxation system.
4. GSTN facility will reduce multiple recordkeeping, lesser investment in manpower and resources and improve efficiency.
5. All interactions will be through common GSTN portal and will ensure corruption free administration.
6. Uniform prices throughout the country. Expansion of business to all states is made easy.

C. To Consumers

1. Input tax credit allowed will lower the prices to the consumers.
2. All small retailers will get exemption and purchases from them will cost less for the consumers.



Disadvantages of GST

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Besides the above listed advantages, the GST is also criticized for many reasons. The disadvantages of GST are stated below:

- i. Several Economists says that GST in India would impact negatively on the real estate market. It would add up to 8percent to the cost of new homes and reduce demand by about 12 percent.
- ii. Another criticism is that CGST, SGST are nothing but new names for Central Excise/Service Tax, VAT and CST. Hence, there is no major reduction in the number of tax layers.
- iii. A number of retail products currently have only four percent tax on them. After GST, garments and clothes could become more expensive.

- iv. The aviation industry would be affected. Service taxes on airfares currently range from six to nine percent. With GST, this rate will surpass fifteen percent and effectively double the tax rate.
- v. Adoption and migration to the new GST system would involve teething troubles and learning for the entire ecosystem.

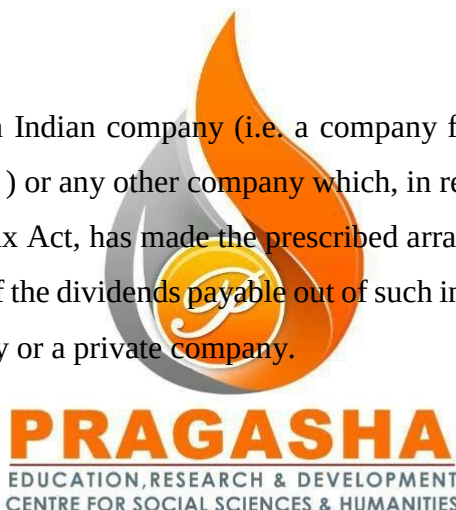
Income Tax Rate for Companies – AY 2019-20

All companies registered in India are required to file income tax returns each year on or before September 30th. Under the Income Tax Act, company tax return filing falls under two categories, namely domestic company or foreign company. This article contains the Income Tax Rate for companies (both domestic and foreign) and the filing procedure.

Domestic Company

Domestic company is an Indian company (i.e. a company formed and registered under the Companies Act, 1956) or any other company which, in respect of its income liable to tax, under the Income Tax Act, has made the prescribed arrangement for declaration and payments within India, of the dividends payable out of such income. A domestic company may be a public company or a private company.

Foreign Company



Foreign company is one whose control and management are situated wholly outside India, and which has not made the prescribed arrangements for declaration and payment of dividends within India.

In this article, we look at the procedure for filing income tax return for a company in detail.

Income Tax Rate for Domestic Companies

Income Tax rate for Domestic Companies for AY 2019-20 | FY 2018-19

The following income tax rates are applicable for domestic companies.

Turnover Details	Tax Rate

Gross turnover upto 250 Cr. in the previous year	25%
Gross turnover exceeding 250 Cr. in the previous year	30%

Surcharge

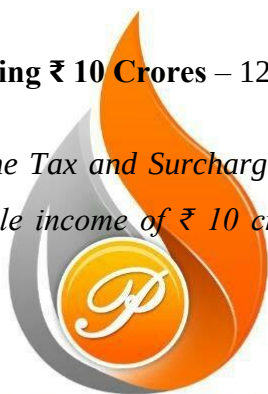
The income tax computed in accordance with above rates, and after being reduced by the amount of tax rebate shall be increased by a surcharge.

- **Taxable Income exceeding ₹ 1 Crore** – 7% of computed income tax.

(However, the amount of Income Tax and Surcharge shall not increase the amount of income tax payable on a taxable income of ₹ 1 crore by more than the amount of increase in taxable income.)

- **Taxable Income exceeding ₹ 10 Crores** – 12% of computed income tax.

(However, the amount of Income Tax and Surcharge shall not increase the amount of income tax payable on a taxable income of ₹ 10 crores by more than the amount of increase in taxable income.)



Health & Education Cess

Health and Education Cess is computed at 4% of the total of Income Tax and Surcharge.

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Income Tax Rate for Foreign Companies

Income Tax Rate for Foreign Companies for AY 2019-20 | FY 2018-19

Nature of Income	Tax Rate
Royalty received from Government or an Indian concern in pursuance of agreement made with the Indian concern after March 31, 1961, but before April 1, 1976, or fees for rendering technical services in pursuance of an agreement made after February 29, 1964 but before April 1, 1976 and where such agreement has, in either case, been approved by the Central Government	50%
Any other Income	40%

Surcharge

The income tax computed in accordance with above rates, and after being reduced by the amount of tax rebate shall be increased by a surcharge.

- **Taxable Income exceeding ₹ 1 Crore** – 2% of computed income tax.

(However, the amount of Income Tax and Surcharge shall not increase the amount of income tax payable on a taxable income of ₹ 1 crore by more than the amount of increase in taxable income.)

- **Taxable Income exceeding ₹ 10 Crores** – 5% of computed income tax.

(However, the amount of Income Tax and Surcharge shall not increase the amount of income tax payable on a taxable income of ₹ 10 crores by more than the amount of increase in taxable income.)

Health & Education Cess

Health and Education Cess is computed at 4% of the total of Income Tax and Surcharge.

Minimum Alternate Tax

All companies are required to pay minimum alternate tax at the rate of 18.5% of book profit plus surcharge and education cess, if the tax liability of the company is less than 18.5% of book profit.

Due Date for Company Tax Return Filing

All companies registered in India are required to file income tax return on or before the 30th of September. Companies incorporated between January – March can file MCA annual return after 18 months in the first year. However, the same type of exemption is not available under the Income Tax Act. Hence, even companies registered from January – March must file income tax return on or before 30th September of the same calendar year.

Type of Tax Return to be Filed by Company

Companies can file two types of income tax returns, namely ITR 6 and ITR 7. Most companies that are operated for profit need to file ITR 6.

Form ITR 6

Companies that are operating a business for profit must file Form ITR 6. Hence, private limited companies, limited companies and one person companies would be required to file Form ITR6.

Form ITR 7

ITR 7 must be filed by companies required to furnish return under sections 139(4A) or 139(4B) or 139(4C) or 139(4D) or 139(4E) or 139(4F). Hence, only Section 8 Company would be required to file income tax return in for ITR 7.

- Return under section 139(4A) is required to be filed by companies in receipt of income derived from property held under trust or other legal obligation wholly for charitable or religious purposes or of income being voluntary contributions.
- Return under section 139(4B) is required to be filed by a political party.
- Return under section 139(4C) is required to be filed by
 - Scientific research association
 - News agency
 - Association or institution
 - Fund or institution or university or other educational institution or any hospital or other medical institution
- Return under section 139(4D) is required to be filed by a university, college or other institution.
- Return under section 139(4E) is required to be filed by a business trust.
- Return under section 139(4F) is required to be filed by an investment fund.

Documents Required for Company Tax Return Filing

ITR return forms are not capable of accepting document attachments. Hence, there is no requirement for filing of any documents with the tax return like identity proof, bank statement, proof of investment, TDS certificates, etc. However, all supporting documents

for the income tax return must be stored by the taxpayer and should be produced before the tax authorities when demanded in an assessment or inquiry.

[Class 2 digital signature](#) is required for filing ITR 6 or ITR 7. Hence, it is important to ensure that the Directors have a valid digital signature before the income tax return filing due date.

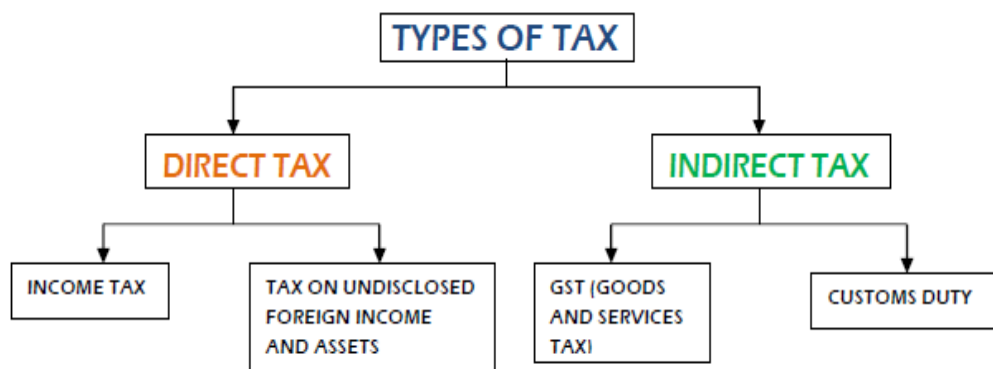
PAN Card for Company

A company is an artificial judicial person having a separate identity. To open a bank account for file income tax returns, PAN is mandatory for a company. Hence, after incorporation of a company, the promoters must apply for PAN for the company in Form 49AA along with a copy of Certificate of Incorporation issued by the Registrar of Companies.

BASIC CONCEPT OF INCOME TAX



TAX –Tax is a fee charged by a Government on a product, income or activity.
There are TWO types of taxes – Direct Taxes and Indirect Taxes.



INCOME TAX: It is a tax on Income.

CHARGING (SEC.4): Every PERSON whose TOTAL INCOME of the PREVIOUS YEAR exceeds the BASIC EXEMPTION LIMIT is an ASSESSEE and chargeable to income tax at the RATES prescribed in the FINANCE ACT for the relevant ASSESSMENT YEAR.

***IMPORTANT CONCEPTS:**

1. Assessee:

“Assessee” means a person by whom any tax or any other sum of money is payable under Income Tax Act, 1961, is called an Assessee.

In addition, it includes –

- Every person in respect of whom any proceeding under this Act has been taken for the assessment of
 - his income; or
 - Assessment of fringe benefits; or
 - the income of any other person in respect of which he is assessable; or
 - the loss sustained by him or by such other person; or
 - the amount of refund due to him or by such other person.
- Every person who is deemed to be an assessee under any provision of this Act;
- Every person who is deemed to be an assessee-in-default under any provision of this Act.

2. Person: A person includes–

An Individual, (HUF), (AOP), Body of Individuals (BOI), a Firm & LLP, a Company, Local Authorities and Artificial Juridical Person etc.

3. Previous year (P.Y.): Previous year is the Financial Year immediately preceding the assessment year i.e., it is the financial year ending on 31st March, in which the income has accrued/received.

4. Assessment Year (A.Y.): means the Period of 12 months commencing on the 1st April every year. F.Y. in which you pay the tax is called A.Y.

5. Financial Year (F.Y.): commences on 1st April and ends on 31st March- (12 Months).

STEPS for computation of TOTAL INCOME and TAX LIABILITY

Determination of Residential Status

Classification of income under 5 heads

Computation of income under each head

Clubbing of income of spouse, minor child etc.

Set off or carry forward & Set off of losses

Computation of Gross Total Income (GTI)

Deductions from GTI

Computation of Tax Liability

Computation of TOTAL INCOME

Income from Salaries (Sec.15-17)	***
Income from House Property (Sec.22-27)	***
Income from PGBP (Sec.28-44AE)	***
Income from Capital Gains (Sec.45-55A)	***
Income from Other Sources (Sec.56-59)	***
LESS/ADD: Clubbing provisions (Sec.60-64)	***
Deemed Income (Sec.66-69D)	***
Set off & C/F of losses (Sec.70-74A)	***
GROSS TOTAL INCOME	***
LESS: Chapter VI A Deductions (80A-80U)	***
NET TOTAL INCOME/ TAXABLE INCOME	***

Computation of TAX PAYABLE

Tax on Total Income	***
LESS/ADD: Rebate/Surcharge	***
LESS: Marginal Relief (if applicable)	***
ADD: Education cess & SHEC@3%	***
Total Tax	***
LESS: Tax Deducted at Source (TDS)	***
LESS: Advance tax paid	***
Net TAX PAYABLE	***

Computation of MARGINAL RELIEF

Tax on Total Income (TI) including Surcharge	**
LESS :[(TI – ##) + (Tax on ## excluding Surcharge)]	**
MARGINAL RELIEF	**

Limit on which Surcharge
Applicable to the Assessee.
(50 lakh /1 Cr./10 Cr.)

Slab Rates applicable for A.Y.2018-19 are as follows:

I. Individual/HUF/AOP/BOI/Artificial Juridical Person:

TAXABLE INCOME (Rs.)	Individual (M/F) Resident (<u><60Yrs.</u>) ** (Non-Resident)	HUF/ AOP/BOI/ Artificial Juridical Person	TAXABLE INCOME (Rs.)	Resident Senior Citizen (<u>>=60& <80Yrs.</u>)	Resident Very Senior Citizen (<u>>=80Yrs.</u>)
UPTO 250000	NIL		UPTO 300000	NIL	
2,50,001–5,00,000	5%		3,00,001–5,00,000	5%	NIL
5,00,001–10,00,000	20%		5,00,001–10,00,000	20%	20%
ABOVE 10,00,000	30%		ABOVE 10,00,000	30%	30%

****** NO AGE LIMIT for all Non-resident Individuals.

II. Firm/LLP/Local Authority: on the Whole of the TOTAL INCOME– **30%**

III. Co-operative society:

Total Income	Rate of tax
UPTO Rs.10,000	10%
Rs.10,001–Rs.20,000	20%
ABOVE Rs.20,000	30%

IV. Company:

Domestic Company	Turnover Or Gross Receipt	RATE
	In the P.Y.2015-16 → <=Rs.50cr.	25% of Total Income
	In other case →	30% of Total Income
Company other than Domestic Company	**NOTE	40% of Total Income

****** However, Specified royalties and fees for rendering technical services (FTS) received from Govt. or an Indian concern in pursuance of an approved agreement made by the Co. with the Govt. or Indian concern between 1.4.1961 and 31.3.1976 (in case of royalties) and between 1.3.1964 and 31.3.1976 (in case of FTS) would be chargeable to tax @50%.

SPECIAL RATES: *Rates are same for all assesses.

Section	Income	Flat Rate*
112	LTCGs	20%
111A	STCGs	15%
115BB	Winnings from lotteries, Crossword puzzles, Race including horse races, Card game, Gambling or betting etc.	30%
115BBDA	Dividend >10 lakhs (in aggregate)	10%
115BBE	Unexplained money, investment, expenditure, etc Deemed as income sec.68-69D	60%

SURCHARGE: It is Tax on Tax.

Assessee	Applicable Surcharge			
	TI > 50 lakhs & ≤ Rs. 1 Cr.	TI > Rs. 1 Cr.	TI > Rs. 1 Cr., but ≤ Rs. 10 Cr.	TI > Rs. 10 Cr.
Individual/HUF/AOP/BOI/AJP	10%	15%		
Firm/LLP, Local Authorities, Co-operative societies & Others	Nil	12%		
Domestic Companies	Nil	→	7%	12%
Foreign Companies	Nil	→	2%	5%

Rebate under Section 87A:

Rebate of up to **Rs. 2,500** for Resident Individuals having Total Income of Up to **Rs. 3.5 lakh**.

“Education Cess & Secondary & Higher Education Cess” on Income tax:

Education cess (EC)	2% of income-tax and surcharge, if applicable
Secondary and Higher Education Cess (SHEC)	1% of income-tax and surcharge, if applicable

ROUNDING OFF TOTAL INCOME-SEC.288A: The Total Income shall be rounded off to the NEAREST **MULTIPLE OF TEN RUPEES**.

ROUNDING OFF OF TAX-SEC.288B: Aggregate of tax, surcharge and education cess payable shall be rounded off to NEAREST **MULTIPLE OF TEN RUPEES**.

Average Rate of tax: SEC.2 (10)

Average Rate of tax = $\frac{\text{Tax payable}}{\text{Total Income}} \times 100$

Maximum marginal rate mean the rate of income-tax (including surcharge on the income-tax, if any) applicable in relation to the highest slab of income in the case of an individual, AOP or BOI, as the case may be, as specified in Finance Act of the relevant year.

Note : Accounting is not included in the book. Kindly refer standard text book

Business Management Book will be shared online