BUSINESS STUDIES

PART II

Business Finance and Marketing

Textbook for Class XII

राष्ट्रीय शैक्षिक अनुसंधान और प्रशिक्षण परिषद्
NATIONAL COUNCIL OF EDUCATIONAL RESEARCH AND TRAINING

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FOREWORD

The National Curriculum Framework (NCF), 2005, recommends that children's life at school must be linked to their life outside the school. This principle marks a departure from the legacy of bookish learning which continues to shape our system and causes a gap between the school, home and community. The syllabi and textbooks developed on the basis of NCF signify an attempt to implement this basic idea. They also attempt to discourage rote learning and the maintenance of sharp boundaries between different subject areas. We hope these measures will take us significantly further in the direction of a child-centred system of education outlined in the National Policy on Education (1986).

The success of this effort depends on the steps that school principals and teachers will take to encourage children to reflect on their own learning and to pursue imaginative activities and questions. We must recognise that, given space, time and freedom, children generate new knowledge by engaging with the information passed on to them by adults. Treating the prescribed textbook as the sole basis of examination is one of the key reasons why other resources and sites of learning are ignored. Inculcating creativity and initiative is possible if we perceive and treat children as participants in learning, not as receivers of a fixed body of knowledge.

These aims imply considerable change in school routines and mode of functioning. Flexibility in the daily time-table is as necessary as rigour in implementing the annual calendar so that the required number of teaching days are actually devoted to teaching. The methods used for teaching and evaluation will also determine how effective this textbook proves for making children's life at school a happy experience, rather than a source of stress or boredom. Syllabus designers have tried to address the problem of curricular burden by restructuring and reorienting knowledge at different stages with greater consideration for child psychology and the time available for teaching. The textbook attempts to enhance this endeavour by giving higher priority and space to opportunities for contemplation and wondering, discussion in small groups, and activities requiring hands-on experience.

The National Council of Educational Research and Training (NCERT) appreciates the hard work done by the textbook development committee responsible for this book. We wish to thank the Chairperson of the advisory group in Social Sciences Professor Hari Vasudevan and the Chief Advisor for this book, Professor D.P.S. Verma *(Retd.)* Delhi School of Economics, University of Delhi and Dr. G.L. Tayal, Reader, Ramjas College, University of Delhi for guiding the work of this committee. Several teachers contributed to the development of this textbook; we are grateful to their principals for making this possible. We are indebted to the institutions and organisations which have generously permitted us to draw upon their resources, material and personnel. We are especially grateful to the members of the National Monitoring Committee, appointed by the Department of Secondary and Higher Education, Ministry of Human Resource Development under the Chairpersonship of Professor Mrinal Miri and Professor. G.P. Deshpande, for their valuable time and contribution. As an organisation committed to the systemic reform and continuous improvement in the quality of its products, NCERT welcomes comments and suggestions which will enable us to undertake further revision and refinement.

Director
National Council of Educational
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New Delhi
20 November 2006

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THE CONSTITUTION OF INDIA

PREAMBLE

WE, THE PEOPLE OF INDIA, having solemnly resolved to constitute India into a [1]**[SOVEREIGN SOCIALIST SECULAR DEMOCRATIC REPUBLIC]** and to secure to all its citizens :

JUSTICE, social, economic and political;

LIBERTY of thought, expression, belief, faith and worship;

EQUALITY of status and of opportunity; and to promote among them all

FRATERNITY assuring the dignity of the individual and the [2][unity and integrity of the Nation];

IN OUR CONSTITUENT ASSEMBLY this twenty-sixth day of November, 1949 do **HEREBY ADOPT, ENACT AND GIVE TO OURSELVES THIS CONSTITUTION.**

1. Subs. by the Constitution (Forty-second Amendment) Act, 1976, Sec.2, for "Sovereign Democratic Republic" (w.e.f. 3.1.1977)
2. Subs. by the Constitution (Forty-second Amendment) Act, 1976, Sec.2, for "Unity of the Nation" (w.e.f. 3.1.1977)

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The Council acknowledges the efforts of *Computer Incharge*, Dinesh Kumar; *DTP Operator,* Uttam Kumar, Archana Gupta and *Sr. Proof Reader,* NCERT, Rishi Pal Singh.

Note to the Teacher

This textbook is expected to provide a good understanding of the environment in which a business operates. A manager has to analyse the complex, dynamic situations in which a business is placed. Therefore, content enrichment in the form of business news and abstracts of articles from business journals and magazines has been given as inset material (boxes). This will encourage students to be observant about all business activity and discover what is happening in business organisations with the expectation that they will update their knowledge through the use of libraries, newspapers, business oriented TV programmes and the internet. Various types of questions are given and case problems have been introduced to test the application of subject knowledge to realistic business situations.

Contents (Part I)

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Constitution of India

Part IV A (Article 51 A)

Fundamental Duties

It shall be the duty of every citizen of India —

(a) to abide by the Constitution and respect its ideals and institutions, the National Flag and the National Anthem;

(b) to cherish and follow the noble ideals which inspired our national struggle for freedom;

(c) to uphold and protect the sovereignty, unity and integrity of India;

(d) to defend the country and render national service when called upon to do so;

(e) to promote harmony and the spirit of common brotherhood amongst all the people of India transcending religious, linguistic and regional or sectional diversities; to renounce practices derogatory to the dignity of women;

(f) to value and preserve the rich heritage of our composite culture;

(g) to protect and improve the natural environment including forests, lakes, rivers, wildlife and to have compassion for living creatures;

(h) to develop the scientific temper, humanism and the spirit of inquiry and reform;

(i) to safeguard public property and to abjure violence;

(j) to strive towards excellence in all spheres of individual and collective activity so that the nation constantly rises to higher levels of endeavour and achievement;

*(k) who is a parent or guardian, to provide opportunities for education to his child or, as the case may be, ward between the age of six and fourteen years.

Note: The Article 51A containing Fundamental Duties was inserted by the Constitution (42nd Amendment) Act, 1976 (with effect from 3 January 1977).

*(k) was inserted by the Constitution (86th Amendment) Act, 2002 (with effect from 1 April 2010).

Notes

NATURE AND SIGNIFICANCE OF MANAGEMENT

1

CHAPTER

Management at HCL

At a time when India had a total of 250 computers, Shiv Nadar led a young team which passionately believed in the growth of the indigenous IT industry. That vision in 1976, born out of a Delhi 'barsaati', has resulted three decades later in creating a US $ 3.5 billion global enterprise. HCL is today a leader in the IT industry, employing 41,000 professionals and having a global presence in 16 countries spanning locations in the US, Europe, Japan, ASEAN and the Pacific Rim. HCL's business today spans IT hardware manufacturing and distribution, system integration, technology and software services, business process outsourcing, and infrastructure management. HCL Enterprises is a leader in global technology and IT services.

HCL's basic plan of developing an indigenous microcomputer bore fruit in 1978 at the same time as Apple and three years before IBM. This was considered by many industry observers as the birth of the Indian computer industry. Under the able direction of its founding fathers it commenced global operations in the US in 1988. Shiv Nadar's risk-taking ability is legendary and he has often made daring forays based on his conviction of the future. At a time when hardware was the name of the game, Nadar foresaw the huge potential in the area of IT education and learning from which NIIT was born. Yet again when software development was still in the nascent stages, Shiv Nadar took the lead and today HCL is a force to reckon with in the global markets. The organisation structure of HCL Enterprises consists of two listed companies in India – HCL Technologies and HCL Infosystems.

Shiv Nadar, Chairman and CEO, attributes the success of the group to its management team and their entrepreneurial spirit, which together have enabled it to handle rapid changes in environments and technologies, and to transform threats into opportunities. Fundamental to the process has been the development of new paradigms for the unprecedented situations into which the group ventures. These include guidelines for organisation restructuring, market creation, technology leveraging

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- Describe the characteristics of management and its importance in an organisation;
- Explain the nature of management as an art, science and profession;
- Explain the functions of management; and
- Appreciate the nature and importance of coordination.

and business up-scaling. Like any other business enterprise profits are important for the survival and growth of HCL as an enterprise.

At HCL the management believes that a satisfied employee creates a satisfied customer, who in turn creates profits that lead to satisfied shareholders.

HCL has a strong sense of social responsibility. It has set up educational institutions in the fields of management, engineering and computer education, in which one-third of the students are girls.

According to Shiv Nadar, the future belongs to the global enterprise which is able to transform itself according to the challenges of global economy.

Source: www.hcl.in

Introduction

The above case is an example of a successful organisation which is amongst the top companies in India. It has risen to the top because of its quality of management. Management is required in all kinds of organisations whether they are manufacturing computers or hand-looms, trading in consumer goods or providing hairstyling services and even in non-business organisations. Let us take another example.

Suhasini is the branch manager of Fabmart, an organisation that promotes the sales of Indian handloom and handicraft products while providing equitable employment to traditional artisans. Fabmart sources its products from over 7500 craft persons and artisans across India. Planning the products is a difficult task that is done by a team of marketing and design experts to ensure that whatever is produced is according to market demand. These plans are then communicated by Suhasini to the rural artisans who actually implement them.

Fabmart is a private limited company with several branches all over the country. It has a complex organisation structure in which actual production is in the hands of several skilled artisans and marketing is done by staff at branches such as the one managed by Suhasini. This means constantly providing direction and motivation to her employees. She also has to ensure that production is carried out according to plans in order to ensure regular sales.

A typical day in Suhasini's life consists of a series of interrelated and continuous functions. She has to plan a special festive collection for Diwali and Christmas. This means organising more funds and recruiting more artisans. She also has to regularly communicate with her suppliers to ensure that deadlines regarding delivery of goods are met. In the course of the day she meets customers for a general feedback and any suggestions that they may have.

Suhasini is the manager of Fabmart. So is Nusli Wadia of Bombay Dyeing, Bill Gates of Microsoft, Shiv Nadar of HCL Enterprises, Indra Nooyi of Pepsico and the Principal of your school. They all manage organisations. Schools, hospitals, shops and large corporations are all organisations with diverse goals that are aimed at achieving something. No matter what the organisation is or what its goals might be, they all have something in common – management and managers.

You have observed that Suhasini's work as a manager consists of a series of different activities or functions aimed at achieving the goals of the organisation. These interconnected and interdependent functions are part of management. Successful organisations do not achieve their goals by chance but by following a deliberate process called 'management'.

Management is essential for all organisations big or small, profit or non-profit, services or manufacturing. Management is necessary so that individuals make their best contribution towards group objectives.

Management consists of a series of interrelated functions that are performed by all managers. Shiv Nadar, the CEO of HCL Enterprises performs all these functions and so does Suhasini at Fabmart. Later in this chapter you will understand that although both of them are managers, they function at different levels in the organisation. The time spent by managers in different functions however is different. Managers at the top level spend more time in planning and organising than managers at lower levels of the organisation.

Concept

Management is a very popular term and has been used extensively for all types of activities and mainly for taking charge of different activities in

Definitions of Management

"Management is the process of designing and maintaining an environment in which individuals, working together in groups, efficiently accomplish selected aims."

Harold Koontz and Heinz Weihrich

"Management is defined as t he process of planning, organising, actuating and controlling an organisation's operations in order to achieve coordination of the human and material resources essential in the effective and efficient attainment of objectives."

Robert L. Trewelly and M. Gene Newport

"Management is the process of working with and through others to effectively achieve organisational objectives by efficiently using limited resources in the changing environment."

Kreitner

any enterprise. As you have seen from the above example and case study that management is an activity which is necessary wherever there is a group of people working in an organisation. People in organisations are performing diverse tasks but they are all working towards the same goal. Management aims at guiding their efforts towards achieving a common objective — a goal. Thus, management has to see that tasks are completed and goals are achieved (i.e., effectiveness) with the least amount of resources at a minimum cost (i.e., efficiency).

Management, has therefore, been defined as a process of getting things done with the aim of achieving goals effectively and efficiently. We need to analyse this definition. There are certain terms which require elaboration. These are (a) process, (b) effectively, and (c) efficiently.

Process in the definition means the primary functions or activities that management performs to get things done. These functions are planning, organising, staffing, directing and controlling which we will discuss later in the chapter and the book.

Being effective or doing work effectively basically means finishing the given task. Effectiveness in management is concerned with doing the right task, completing activities and achieving goals. In other words, it is concerned with the end result.

But it is not enough to just complete the tasks. There is another aspect also, i.e., being efficient or as we say doing work efficiently.

Efficiency means doing the task correctly and with minimum cost. There is a kind of cost-benefit analysis involved and the relationship between inputs and outputs. If by using less resources (i.e., the inputs) more benefits are derived (i.e., the outputs) then efficiency has increased. Efficiency is also increased when for the same benefit or outputs, fewer resources are used and less costs are incurred. Input resources are money, materials, equipment and persons required to do a particular task. Obviously, management is concerned with the efficient use of these resources, because they reduce costs and ultimately lead to higher profits.

Effectiveness versus Efficiency

These two terms are different but they are interrelated. For management, it is important to be both effective and efficient. Effectiveness and efficiency are two sides of the same coin. But these two aspects need to be balanced and management at times, has to compromise with efficiency. For example, it is easier to be effective and ignore efficiency i.e., complete the given task but at a high cost. Suppose, a company's target production is 5000 units in a year. To achieve this target the manager has to operate on double shifts due to power failure most of the time. The manager is able to produce 5000 units but at a higher production cost. In this case, the manager was effective but not so efficient, since for the same output, more inputs (labour cost, electricity costs) were used.

At times, a business may concentrate more on producing goods with fewer resources i.e., cutting down cost but not achieving the target production. Consequently, the goods do not reach the market and hence the demand for them declines and competitors enter the market. This is a case of being efficient but not effective since the goods did not reach the market.

Therefore, it is important for management to achieve goals (effectiveness) with minimum resources i.e., as efficiently as possible while maintaining a balance between effectiveness and efficiency. Usually high efficiency is associated with high effectiveness which is the aim of all managers. But undue emphasis on high efficiency without being effective is also not desirable. Poor management is due to both inefficiency and ineffectiveness.

Characteristics of Management

After going through some of the definitions we find some elements that may be called the basic characteristics of management:

(i) **Management is a goal-oriented process:** An organisation has a set of basic goals which are the basic reason for its existence. These should be simple and clearly stated. Different organisations have different goals. For example, the goal of a retail store may be to increase sales, but the goal of The Spastics Society of India is to impart education to children with special needs. Management unites the efforts of different individuals in the organisation towards achieving these goals.

(ii) **Management is all pervasive:** The activities involved in managing an enterprise are common to all organisations whether economic, social or political. A petrol pump needs to be managed as much as a hospital or a school. What managers do in India, the USA, Germany or Japan is the same. How they do it may be quite different. This difference is due to the differences in culture, tradition and history.

(iii) **Management is multidimensional:** Management is a complex activity that has three main dimensions. These are:

(a) *Management of work:* All organisations exist for the performance of some work. In a factory, a product is manufactured, in a garment

The Management Mantra from GE

Jack Welch was appointed CEO of GE in 1981. At that time the firm had a market capitalisation of $13 billion. In 2000 when he stepped down the firm's turnover had increased multifold to $500 billion. What was the secret of Welch's success? He has laid down the following pointers for managers to be successful:

- ***Create a vision and then ignite your organisation to make this vision a reality.*** Get people so passionate about what they are doing that they cannot wait to execute this plan. Have great energy, competitive spirit and the ability to spark excitement and achieve results. Search for leaders who have the same qualities.
- ***Focus on strategic issues.*** Your job is to understand the vital issues within each of your businesses. Recognise the talent needed to win in those markets.
- ***Focus on the main issue .*** Your job is to see the big picture. Don't manage every detail. Don't get caught up in the minute details, but instead inspire others to execute some of your vision. Surround yourself with great people and trust them to do their job and contribute their best to the organisation.
- ***Involve everyone and welcome great ideas from everywhere.*** Anyone can be a leader, just so long as they contribute, and the most meaningful way for anyone to contribute is to come up with a good idea. Business is all about getting the best ideas from everyone. New ideas are the lifeblood of the organisation, the fuel that makes it run. "The hero is the person with a new idea." There is simply nothing more important to an organisation than expressing ideas and creating a vision.
- ***Lead by example.*** To spark others to perform, you must lead by example. Jack Welch's mastery of the four E's of leadership – Energy, Energise, Edge, and Execution – was always in evidence. "He had great energy, sparked others, had incredible competitive spirit, and had a record of execution that was second to none. This is a key of the Welch phenomenon. Had he been lacking in any of the traits he espoused, he would not have commanded such acclaim."

Source: www.ge.co.in

store a customer's need is satisfied and in a hospital a patient is treated. Management translates this work in terms of goals to be achieved and assigns the means to achieve it. This is done in terms of problems to be solved, decisions to be made, plans to be established, budgets to be prepared, responsibilities to be assigned and authority to be delegated.

(b) *Management of people:* Human resources or people are an organisation's greatest asset. Despite all developments in technology "getting work done through people" is still a major task for the manager. Managing people has two dimensions (i) it implies dealing with employees as individuals with diverse needs and behavior; (ii) it also means dealing with individuals as a group of people.

The task of management is to make people work towards achieving the organisation's goals, by making their strengths effective and their weaknesses irrelevant.

(c) *Management of operations:* No matter what the organisation, it has some basic product or service to provide in order to survive. This requires a production process which entails the flow of input material and the technology for transforming this input into the desired output for consumption. This is interlinked with both the management of work and the management of people.

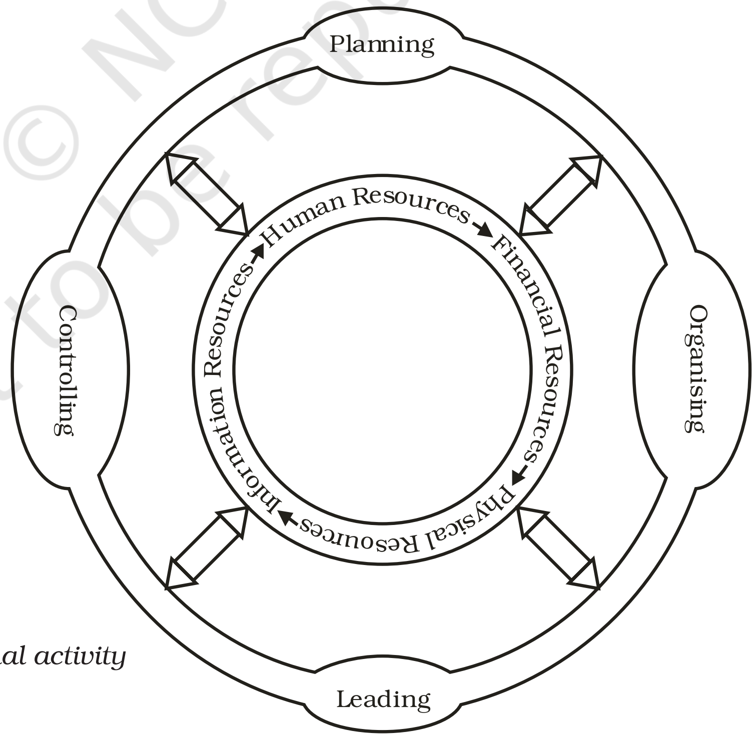
(iv) **Management is a continuous process:** The process of management is a series of continuous, composite, but separate functions (planning, organising, directing, staffing and controlling). These functions are simultaneously performed by all managers all the time. You may have observed that Suhasini at Fabmart performs several different tasks in a single day. Some days she may spend more time in planning a future

Together Everyone Achieves More as a TEAM

exhibition and on another day she may spend time in sorting out an employee's problem. The task of a manager consists of an ongoing series of functions.

(v) **Management is a group activity:** An organisation is a collection of diverse individuals with different needs. Every member of the group has a different purpose for joining the organisation but as members of the organisation they work towards fulfilling the common organisational goal. This requires team work and coordination of individual effort in a common direction. At the same time management should enable all its members to grow and develop as needs and opportunities change.

(vi) **Management is a dynamic function:** Management is a dynamic function and has to adapt itself to the changing environment. An organisation interacts with its external environment which consists of various social, economic and political factors. In order to be successful, an organisation must change itself and its goals according to the needs of the environment. You probably know that McDonalds, the fast food



Management – a multidimensional activity giant made major changes in its menu to be able to survive in the Indian market.

(vii) **Management is an intangible force:** Management is an intangible force that cannot be seen but its presence can be felt in the way the organisation functions. The effect of management is noticeable in an organisation where targets are met according to plans, employees are happy and satisfied, and there is orderliness instead of chaos.

Objectives of Management

Management seeks to achieve certain objectives which are the desired result of any activity. They must be derived from the basic purpose of the business. In any organisation there are different objectives and management has to achieve all objectives in an effective and efficient manner. Objectives can be classified into organisational objectives, social objectives and personal or individual objectives.

(i) **Organisational Objectives:** Management is responsible for setting and achieving objectives for the organisation. It has to achieve a variety of objectives in all areas considering the interest of all stakeholders including, shareholders, employees, customers and the government. The main objective of any organisation should be to utilise human and material resources to the maximum possible advantage, i.e., to fulfill the economic objectives of a business. These are survival, profit and growth.

Survival: The basic objectives of any business is survival. Management must strive to ensure the survival of the organisation. In order to survive, an organisation must earn enough revenues to cover costs.

Profit: Mere survival is not enough for business. Management has to ensure that the organisation makes a profit. Profit provides a vital incentive for the continued successful operation of the enterprise. Profit is essential for covering costs and risks of the business.

Growth: A business needs to add to its prospects in the long run, for this it is important for the business to grow. To remain in the industry, management must exploit fully the growth potential of the organisation. Growth of a business can be measured in terms of sales volume increase in the number of employees, the number of products or the increase in capital investment, etc. There can be other indicators of growth.

(ii) **Social objectives:** It involves the creation of benefit for society. As a part of society, every organisation whether it is business or non-business, has a social obligation to fulfill. This refers to consistently creating economic value for various constituents of society. This includes using environmental friendly methods of production, giving employment opportunities to the disadvantaged sections of society and providing basic amenities like schools and crèches to employees. The box given below illustrates how a company can fulfill its social responsibility.

(iii) **Personal objectives:** Organisations are made up of people who have different personalities, backgrounds, experiences and objectives. They all become part

ITC – Empowering Rural India

A quiet digital revolution is reshaping the lives of farmers in remote Indian villages. In these villages, farmers grow soyabeans, wheat and coffee in small plots of land, as they have done for thousands of years. A typical village has no reliable electricity and has antiquated telephone lines. The farmers are largely illiterate and have never seen a computer. But farmers in these villages are conducting e-business through an initiative called E-Choupal, created by ITC, one of India's largest consumer product and agribusiness companies.

ITC's E-Chaupal initiative is a fine example of a business organisation fulfilling corporate social responsibility. The basic aim of the programme is to provide farmers in rural India with the opportunity to make use of a direct marketing channel eliminating multiple intermediation and wasteful handling and unnecessary transaction costs. It is the single-largest information technology-based intervention by a corporate entity in rural India, transforming the Indian farmer into a progressive knowledge-seeking citizen, enriching him with knowledge and elevating him to a new order of empowerment.

E-Choupal delivers real-time information and customised knowledge to improve the farmer's decision-making ability, thereby better aligning farm output to market demands; securing better quality, productivity and improved price discovery. Given the low levels of literacy in the rural sector, the role of the Choupal Sanchalak, the lead farmer of the village, in facilitating physical interface between the computer terminal and the farmers is central to the project. E-Choupal Smart Cards enable farmer identification to provide customised information on the E-Choupal website. Online transactions are captured to reward farmers for volume and value of usage.

The E-Chaupal initiative has found its way into the Harvard Business School as a leading case study illustarating the use of modern technology by a leading business house for the benefit of the rural poor.

Source: Mohanbir Sawhney, McCormick Tribune Professor of Technology, Kellogg School of Management, USA.

of the organisation to satisfy their diverse needs. These vary from financial needs such as competitive salaries and perks, social needs such as peer recognition and higher level needs such as personal growth and development. Management has to reconcile personal goals with organisational objectives for harmony in the organisation.

Importance of Management

Having understood that management is a universal activity that is integral to any organisation we now examine some of the reasons that have made management so important:

(i) **Management helps in achieving group goals:** Management is required not for itself but for achieving the goals of the organisation. The task of a manager is to give a common direction to the individual effort in achieving the overall goal of the organisation.

(ii) **Management increases efficiency:** The aim of a manager is to reduce costs and increase productivity through better planning, organising, directing, staffing and controlling the activities of the organisation.

(iii) **Management creates a dynamic organisation:** All organisations have to function in an environment which is constantly changing. It is generally seen that individuals in an organisation resist change as it often means moving from a familiar, secure environment into a newer and more challenging one. Management helps people adapt to these changes so that the organisation is able to maintain its competitive edge.

(iv) **Management helps in achieving personal objectives:** A manager motivates and leads his team in such a manner that individual members are able to achieve personal goals while contributing to the overall organisational objective. Through motivation and leadership the management helps individuals to develop team spirit, cooperation and commitment to group success.

(v) **Management helps in the development of society:** An organisation has multiple objectives to serve the purpose of the different groups that constitute it. In the process of fulfilling all these, management helps in the development of the organisation and through that it helps in the development of society. It helps to provide good quality products and services, creates employment opportunities, adopts new technology for the greater good of the people and leads the path towards growth and development.

Nature of Management

Management is as old as civilisation. Although modern organisations are of recent origin, organised activity has existed since the time of the ancient civilisations. In fact, organisations may be considered the distinguishing feature that separated civilised society from uncivilised ones. The earliest management practices were a set of rules and regulations that grew out of the experiences of governmental and commercial activities. The development of trade and commerce gradually led to the development of management principles and practices.

The term 'management' today has several different connotations that highlight the different aspects of its nature. The study of management has evolved over a period of time along with the modern organisations; based both on the experience and practice of managers and a set of theoretical relationships. Over a period of time, it has grown into a dynamic subject with its own special characteristics. However, one question that needs to be addressed pertaining to the nature of management is whether it is a science or an art or both? In order to answer this let us examine the features of both science and art to see how far management fulfills them.

Management as an Art

What is art? Art is the skillful and personal application of existing knowledge to achieve desired results. It can be acquired through study, observation and experience. Since art is concerned with personal application of knowledge some kind of ingenuity and creativity is required to practice the basic principles learnt. The basic features of an art are as follows:

(i) **Existence of theoretical knowledge:** Art presupposes the existence of certain theoretical knowledge. Experts in their respective areas have derived certain basic principles which are applicable to a particular form of art. For example, literature on dancing, public speaking, acting or music is widely recognised.

(ii) **Personalised application:** The use of this basic knowledge varies from individual to individual. Art, therefore, is a very personalised concept. For example, two dancers, two speakers, two actors, or two writers will always differ in demonstrating their art.

(iii) **Based on practice and creativity:** All art is practical. Art involves the creative practice of existing theoretical knowledge. We know that all music is based on seven basic notes. However, what makes the composition of a musician unique or different is his use of these notes in a creative manner that is entirely his own interpretation.

Management can be said to be an art since it satisfies the following criteria:

(i) A successful manager practices the art of management in the day-to-day job of managing an enterprise based on study, observation and experience. There is a lot of literature available in various areas of management like marketing, finance and human resources which the manager has to specialise in. There is existence of theoretical knowledge.

(ii) There are various theories of management, as propounded by many management thinkers, which prescribe certain universal principles. A manager applies these scientific methods and body of knowledge to a given situation, an issue or a problem, in his own unique manner. A good manager works through a combination of practice, creativity, imagination, initiative and innovation. A manager achieves perfection after long practice. Students of management also apply these principles differently depending on how creative they are.

(iii) A manager applies this acquired knowledge in a personalised and skillful manner in the light of the realities of a given situation. He is involved in the activities of the organisation, studies critical situations and formulates his own theories for use in a given situation. This gives rise to different styles of management

The best managers are committed and dedicated individuals; highly trained and educated, with personal qualities such as ambition, self-motivation, creativity and imagination, a desire for development of the self and the organisation they belong to. All management practices are based on the same set of principles; what distinguishes a successful manager from a less successful one is the ability to put these principles into practice.

Management as a Science

Science is a systematised body of knowledge that explains certain general truths or the operation of general laws. The basic features of science are as follows:

(i) **Systematised body of knowledge:** Science is a systematic body of knowledge. Its principles are based on a cause and effect relationship. For example, the phenomenon of an apple falling from a tree towards the ground is explained by the law of gravity.

(ii) **Principles based on experimentation:** Scientific principles are first developed through observation and then tested through repeated experimentation under controlled conditions.

(iii) **Universal validity:** Scientific principles have universal validity and application.

Based on the above features, we can say that management has some characteristics of science.

(i) Management has a systematised body of knowledge. It has its

Some Interesting Cross-disciplinary Perspectives

Anthropology – Anthropology is the study of societies, which helps us learn about human beings and their activities. Anthropologists' work on cultures and environments, for instance, has helped managers to better understand differences in fundamental values, attitudes, and behavior between people in different countries and within different organisations.

Economics – Economics is concerned with the allocation and distribution of scarce resources. It provides us with an understanding of the changing economy as well as the role of competition and free markets in a global context. An understanding of free trade and protectionist policies is absolutely essential to any manager operating in the global marketplace, and these topics are addressed by economists.

Philosophy – Philosophy courses inquire into the nature of things, particularly values and ethics. Ethics are standards that govern human conduct. These ethics have shaped today's organisations by providing a basis for legitimate authority, linking rewards to performance, and justifying the existence of business and the corporate form.

Political Science – Political science is the study of the behavior of individuals and groups within a political environment. Management is affected by a nation's form of government – by whether it allows its citizens to hold property, by its citizens' ability to engage in and enforce contracts, and by the appeal mechanisms available to redress grievances. A nation's stand on property, contracts, and justice, in turn, shapes the type, form, and policies of its organisations.

Psychology – Psychology is the science that seeks to measure, explain, and sometimes change the behaviour of humans and other animals. Today's managers confront both a diverse customer base and a diverse set of employees. Psychologists' efforts to understand gender and cultural diversity provide managers with a better perception of the needs of their changing customer and employee populations. Psychology courses are also relevant to managers in terms of gaining a better understanding of motivation, leadership, trust, employee selection, performance appraisals, and training techniques.

Sociology – Sociology is the study of people in relation to their fellow human beings. What are some of the sociological issues that have relevance to managers? Here are a few. How are societal changes such as globalisation, increasing cultural diversity, changing gender roles, and varying forms of family life affecting organisational practices? What are the implications of schooling practices and education trends on future employees' skills and abilities? Answers to questions such as these have a major effect on how managers operate their businesses.

Source: Fundamentals of Management
Stephen P. Robbins
David A. DeCenzo

own theory and principles that have developed over a period of time, but it also draws on other disciplines such as Economics, Sociology, Psychology and Mathematics. Like all other organised activity, management has its own vocabulary of terms and concepts. For example, all of us discuss sports like cricket and soccer using a common vocabulary. The players also use these terms to communicate with each other. Similarly managers need to communicate with one another with the help of a common vocabulary for a better understanding of their work situation.

(ii) The principles of management have evolved over a period of time based on repeated experimentation and observation in different types of organisations. However, since management deals with human beings and human behaviour, the outcomes of these experiments are not capable of being accurately predicted or replicated. Therefore, management can be called an inexact science. Despite these limitations, management scholars have been able to identify general principles of management. For example, scientific management principles by F.W. Taylor and Functional Management principles by Henri Fayol which you will study in the next chapter.

(iii) Since the principles of management are not as exact as the principles of science, their application and use is not universal. They have to be modified according to a given situation. However, they provide managers with certain standardised techniques that can be used in different situations. These principles are also used for training and development of managers.

You must have understood from the foregoing discussion that management has features of both art and science. The practice of management is an art. However, managers can work better if their practice is based on the principles of management. These principles constitute the science of management. Management as an art and a science are therefore not mutually exclusive, but complement each other.

Management as a Profession

You have understood so far that all forms of organised activity need to be managed. You would also have observed that organisations look for individuals with specific qualifications and experience to manage them. It has also been observed that there has been an increase in the corporate form of business on the one hand and increasing emphasis on managed business concerns. Does this imply that management is a profession? To answer this question let us examine the salient features of a profession and see whether management satisfies them.

A profession has the following characteristics:

(i) **Well-defined body of knowledge**: All professions are based on a well-defined body of knowledge that can be acquired through instruction.

(ii) **Restricted entry:** The entry to a profession is restricted through an examination or through acquiring an educational degree. For example, to become a chartered accountant in India a candidate has to clear a specified examination conducted by the Institute of Chartered Accountants of India.

(iii) **Professional association:** All professions are affiliated to a professional association which regulates entry, grants certificate of practice and formulates and enforces a code of conduct. To be able to practice in India lawyers have to become members of the Bar Council which regulates and controls their activities.

(iv) **Ethical code of conduct:** All professions are bound by a code of conduct which guides the behaviour of its members. All doctors, for example, take the oath of ethical practice at the time they enter the profession.

(v) **Service motive:** The basic motive of a profession is to serve their client's interests by rendering dedicated and committed service. The task of a lawyer is to ensure that his client gets justice.

Management does not meet the exact criteria of a profession. However, it does have some of the features of a profession:

(i) All over the world there is marked growth in management as a discipline. It is based on a systematic body of knowledge comprising well-defined principles based on a variety of business situations. This knowledge can be acquired at different colleges and professional institutes and through a number of books and journals. The subject of management is taught at different institutions. Some of these have been set up with the specific purpose of providing management education such as the Indian Institutes of Management (IIMs) in India. Entry to different institutes is usually through an examination.

(ii) There is no restriction on anyone being designated or appointed as manager in any business enterprise. Anyone can be called a manager irrespective of the educational qualifications possessed.

Unlike professions such as medicine or law which require a practicing doctor or lawyer to possess valid degrees, nowhere in the world is it mandatory for a manager to possess any such specific degree. But professional knowledge and training is considered to be a desirable qualification, since there is greater demand for those who possess degrees or diplomas from reputed institutions. Therefore, as such the second criterion has not been strictly met.

(iii) There are several associations of practising managers in India, like the AIMA (All India Management Association) that has laid down a code of conduct to regulate the activities of their members. There is, however, no compulsion for managers to be members of such an association nor does it have any statutory backing.

(iv) The basic purpose of management is to help the organisation achieve its stated goal. This may be profit maximisation for a business enterprise and service for a hospital. However, profit maximisation as the objective of management does not hold true and is fast changing. Therefore, if an organisation has a good management team that is efficient and effective it automatically serves society by providing good quality products at reasonable prices.

Levels of Management

Shiv Nadar and Suhasini are both managers of an enterprise. Shiv Nadar is the CEO of HCL and Suhasini is a branch manager at Fabmart. They manage their enterprise at different levels. Management is a universal term used for certain functions performed by individuals in an enterprise who are bound together in a hierarchy of relationships. Every individual in the hierarchy is responsible for successful completion of a particular task. To be able to fulfill that responsibility he is assigned a certain amount of authority or the right to take a decision. This authority-responsibility relationship binds individuals as superiors and subordinates and gives rise to different levels in an organisation. Generally speaking there are three levels in the hierarchy of an organisation.

(i) **Top Management:** They consist of the senior-most executives of the organisation by whatever name they are called. They are usually referred to as the chairman, the chief executive officer, chief operating officer, president and vice-president. Top management is a team consisting of managers from different functional levels, heading finance, marketing etc. For example chief finance officer, vice president (marketing). Their basic task is to integrate diverse elements and coordinate the activities of different departments according to the overall objectives of the organisation. These top level managers are responsible for the welfare and survival of the organisation. They analyse the business environment and its implications for the survival of the firm. They formulate overall organisational goals and strategies for their achievement. They are responsible for all the activities of the business and for its impact on society. The job of the top manager is complex and stressful, demanding long hours and commitment to the organisation.

(ii) **Middle Management:** is the link between top and lower level managers. They are subordinate to top managers and superior to the first line managers. They are usually known as division heads, for example production manager. Middle management is responsible for implementing and controlling plans and strategies developed by top management. At the same time they are responsible for all the activities of first line managers. Their main task is to carry out the plans formulated by the top managers. For this they need to: (i) interpret the policies framed by top management, (ii) ensure that their department has the necessary personnel, (iii) assign necessary duties and responsibilities to them, (iv) motivate them to achieve desired objectives, and (v) co-operate with other departments for smooth functioning of the organisation. At the same time they are responsible for all the activities of first line managers.

(iii) **Supervisory or Operational Management:** Foremen and supervisors comprise the lower level in the hierarchy of the organisation. Supervisors directly oversee the efforts of the workforce. Their authority and responsibility is limited according to the plans drawn by the top management. Supervisory management plays a very important role in the organisation since they interact with the actual work force and pass on instructions of the middle

"You don't learn management from books alone..."

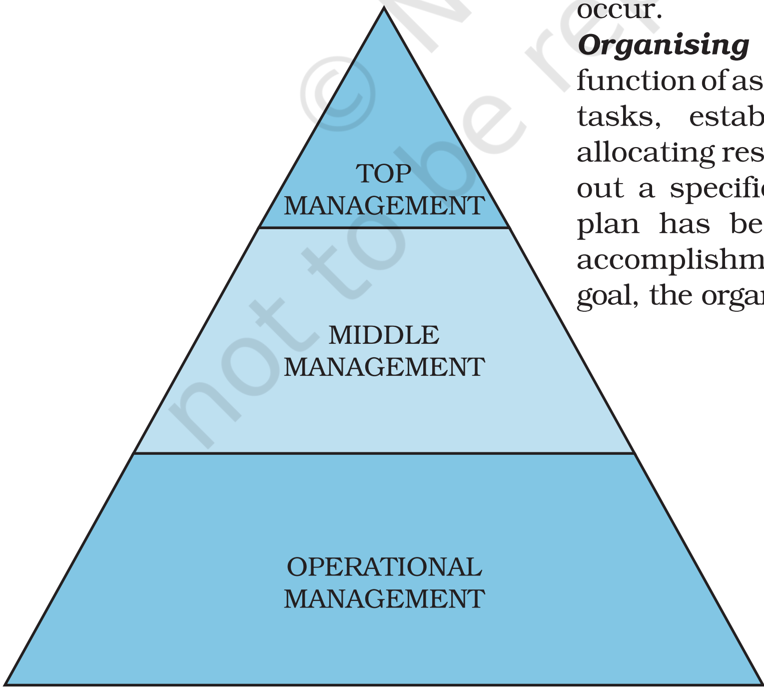
management to the workers. Through their efforts quality of output is maintained, wastage of materials is minimised and safety standards are maintained. The quality of workmanship and the quality of output depends on the hard work, discipline and loyalty of the workers.

Functions of Management

Management is described as the process of planning, organising, directing and controlling the efforts of organisational members and of using organisational resources to achieve specific goals.

Planning is the function of determining in advance what is to be done and who is to do it. This implies setting goals in advance and developing a way of achieving them efficiently and effectively. In Suhasini's organisation the objective is procurement and sale of traditional Indian handloom and handicraft items. They sell fabrics, furnishings, readymades and household items made out of traditional Indian fabrics. Suhasini has to decide quantities, variety, colour and texture of all the above and then allocate resources for their purchase from different suppliers or for their inhouse development. Planning cannot prevent problems, but it can predict them and prepare contingency plans to deal with them if and when they occur.

Organising is the management function of assigning duties, grouping tasks, establishing authority and allocating resources required to carry out a specific plan. Once a specific plan has been established for the accomplishment of an organisational goal, the organising function examines



Managerial Levels

the activities and resources required to implement the plan. It determines what activities and resources are required. It decides who will do a particular task, where it will be done, and when it will be done. Organising involves the grouping of the required tasks into manageable departments or work units and the establishment of authority and reporting relationships within the organisational hierarchy. Proper organisational techniques help in the accomplishment of work and promote both the efficiency of operations and the effectiveness of results. Different kinds of business require different structures according to the nature of work. You will read more about this in a later chapter.

Staffing simply stated, is finding the right people for the right job. A very important aspect of management is to make sure that the right people with the right qualifications are available at the right places and times to accomplish the goals of the organisation. This is also known as the human resource function and it involves activities such as recruitment, selection, placement and training of personnel. Infosys Technologies which develops software needs systems analysts and programmers, whereas Fabmart needs a team of designers and craftspeople.

Directing involves leading, influencing and motivating employees to perform the tasks assigned to them. This requires establishing an atmosphere that encourages employees to do their best. Motivation and leadership are two key components of direction. Directing also involves communicating effectively as well as supervising employees at work. Motivating workers means simply creating an environment that makes them want to work. Leadership is influencing others to do what the leader wants them to do. A good manager directs through praise and criticism in such a way that it brings out the best in the employee. Suhasini's design team developed some prints for bedcovers in bright colours on silk. Although they looked very impressive, the use of silk made the product too expensive for the average customer. Praising their effort, Suhasini suggested that they keep the silk bedcovers for special occasions like Diwali and Christmas and offer the cotton bedcovers on a regular basis.

Controlling is the management function of monitoring organisational performance towards the attainment of organisational goals. The task of controlling involves establishing standards of performance, measuring current performance, comparing this with established standards and taking corrective action where any deviation is found. Here management must determine what activities and outputs are critical to success, how and where they can be measured and who should have the authority to take corrective action. When Suhasini discovered that her team of designers had produced bedcovers that were more expensive than they had planned to sell, she decided to change the fabric to keep costs in check.

The various functions of a manager are usually discussed in the order given above, suggesting that a manager first plans, then organises, puts staff in position, then directs, and finally controls. In reality, managers are rarely able to carry out these functions in isolation. The activities of a manager are interrelated and it is often difficult to pinpoint where one ended and the other began.

Coordination — The Essence of Management

You have understood by now that a manager has to perform five interrelated functions in the process of managing an organisation which is a system made up of different interlinked and interdependent subsystems. A manager has to link these diverse groups towards the achievement of a common goal. The process by which a manager synchronises the activities of different departments is known as coordination.

Coordination is the force that binds all the other functions of management. It is the common thread that runs through all activities such as purchase, production, sales, and finance to ensure continuity in the working of the organisation. Coordination is sometimes considered a separate function of management. It is however, the essence of management, for achieving harmony among individual efforts towards the accomplishment of group goals. Each managerial function is an exercise contributing individually to coordination. Coordination is implicit and inherent in all functions of an organisation.

The process of coordinating the activities of an organisation begins at the planning stage itself. Top management plans for the entire organisation. According to these plans the organisational structure is developed and staffed. In order to ensure that these plans are executed according to plans directing is required. Any discrepancies between actual and realised activities are then taken care of at the stage of controlling. It is through the process of coordination that a manager ensures the orderly arrangement of individual and group efforts to ensure unity of action in the realisation of common objectives. Coordination therefore involves synchronisation of the different actions or efforts of the various units of an organisation. This provides the requisite amount, quality, timing and sequence of efforts which ensures that planned objectives are achieved with a minimum of conflict.

Characteristics of Coordination

The definitions given above highlight the following features of coordination:

(i) **Coordination integrates group efforts:** Coordination unifies unrelated or diverse interests into purposeful work activity. It gives a common focus to group effort to ensure that performance is as it was planned and scheduled.

(ii) **Coordination ensures unity of action:** The purpose of coordination is to secure unity of action in the realisation of a common purpose. It acts as the binding force between departments and ensures that all action is aimed at achieving the goals of the organisation. You have observed that at Fabmart, the production and sales department have to coordinate their work, so that production takes place according to the demand in the market.

In the absence of coordination what results is chaos

(iii) **Coordination is a continuous process:** Coordination is not a one-time function but a continuous process. It begins at the planning stage and continues till controlling. Suhasini plans her winter collection in the month of June itself. She has to then ensure that there is adequate workforce and continuously monitor whether production is proceeding according to plans. Her marketing department also has to be briefed in time to prepare their promotional and advertising campaigns.

(iv) **Coordination is an all pervasive function:** Coordination is required at all levels of management due to the interdependent nature of activities of various departments. It integrates the efforts of different departments and different levels. The purchase, production and sales departmental efforts have to be coordinated by Suhasini for achieving organisational objectives harmoniously. The purchase department is responsible for procuring fabric. This then becomes the basis of the activities of the production department and finally sales can take place. If fabric purchased is of an inferior quality or is not according to the specifications of the production department, further sales will also decline. In the absence of coordination there is overlapping and chaos instead of harmony and integration of activities.

(v) **Coordination is the responsibility of all managers:** Coordination is the function of every manager in the organisation. Top level managers need to coordinate with their subordinates to ensure that the overall policies for the organisation are duly carried out. Middle level management coordinates with both the top level and first line managers. Operational level management coordinates the activities of its workers to ensure that work proceeds according to plans.

(vi) **Coordination is a deliberate function:** A manager has to coordinate the efforts of different people in a conscious and deliberate manner. Even where members of a department willingly cooperate and work, coordination gives a direction to that willing spirit. Cooperation in the absence of coordination may lead to wasted effort and coordination without cooperation may lead to dissatisfaction among employees.

Coordination, therefore, is not a separate function of management, but its very essence. For an organisation to effectively and efficiently achieve its objectives coordination is required. Like a thread in a garland, coordination is a part of all management functions.

Importance of Coordination

Coordination is important as it integrates the efforts of individuals, departments and specialists. The primary reason for coordination is that departments and individuals in the organisation are interdependent, i.e. they depend on each other for information and resources to perform their respective activities. Thus, managers need to reconcile differences in approach, timing, effort or interest. At the same time, there is a need to harmonise individual goals and organisational goals.

Definitions of Coordination

Coordination is balancing and keeping together the team by ensuring suitable allocation of tasks to the various members and seeing that the tasks are performed with harmony among the members themselves. *E.F.L. Brech*

Coordination is the process whereby an executive develops an orderly pattern of group efforts among his subordinates and secures unity of action in the pursuit of common purpose. *McFarland*

Coordination is the orderly synchronising of efforts of subordinates to provide proper amount, timing and quality of execution so that their united efforts lead to the stated objectives, namely, the common purpose of the enterprise. *Theo Haimann*

(i) **Growth in size:** As organisations grow in size, the number of people employed by the organisation also increases. At times, it may become difficult to integrate their efforts and activities. All individuals differ in their habits of work, background, approaches to situations and relationships with others. It becomes necessary to ensure that all individuals work towards the common goals of the organisation. But employees may have their own individual goals also. Therefore, for organisational efficiency, it is important to harmonise individual goals and organisational goals through coordination.

(ii) **Functional differentiation:** Functions of an organisation are divided into departments, divisions and sections. In an organisation there may be separate departments of finance, production, marketing or human resources. All these departments may have their own objectives, policies and their own style of working. For example, the marketing department's objective may be to increase sales by 10 per cent by offering discounts. But, the finance department may

'DABBAWALLAS' – Excellence through Coordination

The Dabbawallas of Mumbai is the story of a SIX SIGMA business enterprise. The success of the business lies in the complex yet well coordinated exercise that is carried out on the streets of Mumbai day after day. What is the secret behind the efficiency with which their business is conducted?

The story of the dabbawallas begins in the kitchens of Mumbai. After they step out of their door, someone begins the time-consuming process of preparing the worker a fresh, home-cooked lunch. What happens next for demonstrates the coordination of the dabbawallas system. The first dabbawalla picks up the tiffin from home and takes it to the nearest railway station.The second dabbawalla sorts out the dabbas at the railway station according to destination and puts them in the luggage carriage. The third one travels with the dabbas to the railway stations nearest to the destinations. The fourth one picks up dabbas from the railway station and drops them off at the offices.

By mid-morning, thousands of dabbawallas are bicycling through the streets of Mumbai, ensuring a hot home cooked lunch for their customers. The whole tiffin distribution requires negligible technology. The dabbawallas rely on low capital and use cycles, wooden carriages and local trains to achieve their target.There are several groups that work independently and network with each other to achieve their goal.

Each area is divided into several small distribution sectors and each sector is handled by a particular person. This person understands the address in that locality very well. Also, this perfection comes with practice. Many new employees work for months under the guidance of their seniors.

Punctuality and time management are on top of the agenda for dabbawallas. Whatever be the circumstances, the dabbawallas never get delayed even by a few minutes.

not approve of such discounts as it means loss of revenue. These kinds of conflict arise in organisations because each unit/department is performing activities in isolation from others and barriers between departments are becoming more rigid.

However, all departments and individuals are interdependent and they have to depend on each other for information to perform their activities. The activity of each department needs to be focused on attainment of common organisational goals. The process of linking the activities of various departments is accomplished by coordination.

(iii) **Specialisation:** Modern organisations are characterised by a high degree of specialisation. Specialisation arises out of the complexities of modern technology and the diversity of tasks to be performed. Organisations, therefore, need to employ a number of specialists. Specialists usually think that they only are qualified to evaluate, judge and decide according to their professional criteria. They do not take advice or suggestions from others in matters pertaining to their area of specialisation. This often leads to conflict amongst different specialists as well as others in the organisation. Therefore, some coordination is required by an independent person to reconcile the differences in approach, interest or opinion of the specialists.

The Challenge of Being a Global Manager

Rajat Lal is the director of a firm that develops software solutions for the travel industry on a global level. He represents a US software services firm that outsources project work to its delivery partners in Gurgaon, the software hub of North India. It develops software for companies in the technology, transportation and leisure sectors, across the world. Rajat is the interface between his global clients and his domestic technical team. That makes his job more challenging than that of a manager who functions in a totally domestic environment. This is what Rajat has to say about the challenges of his job:

- **In the capacity of the 'country manager'** – the global manager has to deal with establishing his company's legal and business presence in the form of a local office or business partner, contacting and negotiating with clients, with legal bodies including lawyers and immigration authorities since the services involve having technical staff from India to be based in USA/Europe, as also with local companies offering recruitment services. Another key role he plays is establishing a sense of comfort in potential clients by stressing on the positive effects of cross-cultural and multi-cultural opportunities that outsourcing and global delivery entail, while addressing any concerns out of these.
- **In the capacity of the 'functional manager'** – the global manager has to ensure he is able to source the right technical skills, build a strong resource base of these skills, and be able to deliver on software projects with these skill-sets working in a globalised

work environment – in terms of multiple time-zones, understanding of client's priorities based on the business cycles that the client's business operates in, understanding and adapting to the processes and methodologies the client is familiar with. Finally this function also includes customer expectation management, where the functional manager has to coordinate activities in India and in USA/Europe according to the customer's priorities, communicate what is possible and what is not possible, and accordingly also manage the expectations and satisfaction levels of his own employees.

- **In the capacity of the 'business leader'** – the global manager has to be alive to changing business situations and customer priorities – he has to keep track of the trends in outsourcing – and have the ability to envision upcoming opportunities as well as potential risks. For example, having a firm grip on the changing legislations on outsourcing is critical for a business manager to understand if his current clients are going to continue giving him business. The global manager also needs to be extremely responsive in what customers may perceive as gaps between the operating environment in India vis-à-vis their own countries. He has to position the advantages that outsourcing to India offers – in terms of lowered costs and access to a wide talent-base, while expertly addressing concerns on weak areas like infrastructure in India.

What do all these mean for a global manager today?

To summarise, a global manager today is one who possesses what can be termed as 'hard' types of skills as well as 'softer' types of skills. Managers who understand analysis, strategy, engineering, and technology are still going to be needed, but extremely critical to global success are people who understand how teams work, how organisations work, how people are motivated.

A manager who really understands different cultures should be able to work in a West European, non-English speaking country, then move to a developing country like Malaysia or Kenya, and then be transferred to an office based in New York, USA, and be almost immediately productive in all three places.

It can thus be understood that the role of a global manager has evolved in much the same way that the global industry and economy have evolved. It has changed from being a single dimensional role in a defined business context, to being a multi-faceted role that calls for a diverse combination of technical skills, soft management and people skills, and the ability to imbibe and learn different cultural experiences.

Source: Harvard Business School, Working Knowledge

Management in the Twenty-first Century

Even as you read this chapter, the organisation and its management are changing. As boundaries between cultures and nations get blurred and new communication technology makes it possible to think of the world as a 'global village', the scope of international and intercultural relationships is rapidly expanding. The modern organisation is a global organisation that has to be managed in a global perspective. What does this imply?

Key Terms

Management | Process | Efficiency | Effectiveness | Art | Science | Profession | Planning | Organising | Staffing | Directing | Controlling | Coordination

Summary

Concept
Management is the process of planning, organising, staffing, directing and controlling the enterprise resources efficiently and effectively for achieving the goals of the organisation. Effectiveness in management is concerned with doing the right task, completing activities and achieving goals. Efficiency means doing the task correctly and with minimum cost.

Characteristics
The key features of management are: (i) goal oriented process (ii) all pervasive (iii) multidimensional (iv) continuous process (v) group activity (vi) dynamic function (vii) tangible force.

Objectives
Management fulfills three basic objectives: organisational, social and personal.

Importance
Management is important because it helps in achieving group goals, increases efficiency, creates a dynamic organisation, helps achieve personal objectives and contributes to the development of society.

Nature
Management is a combination of an organised body of knowledge (science) and its skillful application (art). Although it does not satisfy all the requirements of a profession, it is to a large extent professional in character.

Levels
Management is considered a three-tier activity. The top management focuses on determination of objectives and policies, middle management attempts to achieve these objectives through the effort of other managers and supervisory or operational management directly oversees the efforts of the workforce.

Functions
All managers perform the following interrelated functions: Planning, Organising, Staffing, Directing and Controlling.

Coordination
Coordination is the essence of management. It is the process of achieving unity of action among interdependent activities and departments of an organisation.

Exercises

Short Answer Type

1. Define management.
2. Name any two important characteristics of management.
3. Ritu is the manager of the northern division of a large corporate house. At what level does she work in the organisation? What are her basic functions?
4. Why is management considered a multi-faceted concept?
5. Discuss the basic features of management as a profession.

Long Answer Type

1. Management is considered to be both an art and science. Explain.
2. Do you think management has the characteristics of a full fledged profession?
3. Coordination is the essence of management. Do you agree? Give reasons.
4. "A successful enterprise has to achieve its goals effectively and efficiently." Explain.
5. Management is a series of continuous interrelated functions. Comment.

Multiple Choice

1. Which is not a function of management of the following
   (a) planning
   (b) staffing
   (c) cooperating
   (d) controlling
2. management is
   (a) an art
   (b) a science
   (c) both art and science
   (d) neither
3. the following is not an objective of management
   (a) earning profits
   (b) growth of the organisation
   (c) providing employment
   (d) policy making
4. policy formulation is the function of
   (a) top level managers

   (b) middle level managers
   (c) operational management
   (d) all of the above

5. coordination is
   (a) function of management
   (b) the essence of management
   (c) an objective of management
   (d) none of the above

Case Problems

1. Company X is facing a lot of problems these days. It manufactures white goods like washing machines, microwave ovens, refrigerators and air conditioners. The company's margins are under pressure and the profits and market share are declining. The production department blames marketing for not meeting sales targets and marketing blames production department for producing goods, which are not of good quality meeting customers expectations. The finance department blames both production and marketing for declining return on investment and bad marketing.

   What quality of management do you think the company is lacking? Explain briefly. What steps should the company management take to bring the company back on track?

2. A company wants to modify its existing product in the market due to decreasing sales. You can imagine any product about which you are familiar. What decisions/steps should each level of management take to give effect to this decision?

3. A firm plans in advance and has a sound organisation structure with efficient supervisory staff and control system. On several occasion it finds that plans are not being adhered to. It leads to confusion and duplication of work. Advise remedy.

These activities are meant to reinforce concepts and to make the learning joyful. They also aim to give pupils simulated experiences of the managerial activities relevant to their level of understanding.

Activity 1

Make groups of 5 – 6 students each according to the size of class. Let them run a garment manufacturing company. Assign the following tasks to each group.

(i) Let group 'A' identify the activities that take place in the company.

(ii) Let group 'B' classify these activities into managerial and non-managerial activities.

(iii) Let group 'C' identify the planning activities.

(iv) Let group 'D' identify the organising activities.

(v) Let group 'E' identify the staffing activities.

(vi) Let group 'F' identify the directing activities.

(vii) Let group 'G' identify the controlling activities.

(viii) Let group 'H' identify the coordinating activities.

The teacher can then summarise these activities and derive appropriate conclusions. The above activity can be done for any sector such as software export house, or an auto company. The teacher should do some preparation in finding out the actual activities with the help of Internet and printed material relevant to the sector which is selected. The students can also be involved in the searching exercise by the teacher.

Activity 2

This activity involves classifying the activities identified in activity 1 into those taking place at higher management level, middle management level and lower management level. Accordingly 3 groups A, B and C can be formed for the three levels. If the teacher so desires she/he can form more groups. Then the findings of the groups can be summarised by the teacher.

Note: The teacher can organise a panel discussion for both these activities where the group leaders can give their findings and the students of the class can ask questions which can be answered by the panel members with the help of the teacher.

It should be noted that no expertise is required for the students. This exercise is just to give the feel to the students of the real life work environment and relate it to what they have learnt.

PRINCIPLES OF MANAGEMENT

2

CHAPTER

Business Principles of Toyota Motor Corporation

Toyota follows certain well-defined business principles guiding its functioning. These are:

1. Honour the language and spirit of law of every nation and undertake open and fair corporate activities to be a good corporate citizen around the world.
2. Respect the culture and customs of every nation and contribute to economic and social development through corporate activities in local communities.
3. To provide clean and safe products and to enhance the quality of life everywhere.
4. Create and develop advanced technologies and provide outstanding products and services that fulfil the needs of customers worldwide.
5. Foster a corporate culture that enhances individual creativity and teamwork value, while honouring mutual trust and respect between management and labour.
6. Pursue growth and harmony with global community through innovative management.
7. Work with business partners in research and creativity to achieve stable, long-term growth and mutual benefits and be open to new partnerships. These principles, will guide the company in its global vision 2010. This global vision envisages continuous innovations in future, use of environment friendly technologies, respecting and working with different sections of society and establishing an interactive relationship with society.

Based on www.toyota.co.jp/en/enviornmental_rep/03 /rinen.html on 17.10.2006

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- State the meaning, nature and significance of principles of management;
- Explain Taylor's principles and techniques of Scientific Management; and
- Explain Fayol's principles of management.

It is clear from the foregoing case that managerial pursuits at Toyota Motor Corporation are driven by principles that serve as broad guidelines for stating the vision as well as the ways to achieve it. Similarly, many other business enterprises have followed various principles in their working over a period of time. A number of management thinkers, and writers have also studied principles of management from time-to-time. In fact, there is a long history of management thought. Management principles have evolved and are in the continuous process of evolution. (see box.)

You can see that the evolution of management thought has been very fascinating. In this chapter we will study the contributions of Fredrick Winslow Taylor and Henri Fayol who as you have read are associated with the classical management theory. Both of them contributed immensely towards the study of management as a discipline. Whereas F.W. Taylor was an American mechanical engineer, Henri Fayol was a French mining engineer. Taylor gave the concept

Evolution of Management Principles

In tracing the history of management, one comes across various schools of thought that have outlined principles to guide management practices. These schools of thought may be divided into 6 distinctive phases: I. Early Perspectives; 2. Classical Management Theory; 3. Neo Classical Theory — Human Relations Approach; 4. Behavioural Science Approach — Organisational Humanism; 5. Management Science/Operational Research; 6. Modern Management.

EARLY PRESPECTIVES

The first known management ideas were recorded in 3000-4000 B.C. One Pyramid built by Egyptian ruler Cheops required work to be done by 100,000 men for over twenty years in 2900 B.C. It covered 13 acres of land and measured 481 meters in height. The stone slabs had to be moved thousands of kilometres of distance. As folklore goes, even the sound of a hammer was not heard in the villages in the vicinity of the site of these pyramids. Such monumental work could not be completed without adherence to principles of sound management.

CLASSICAL MANAGEMENT THEORY

Rational economic view, scientific management, administrative principles, and bureaucratic organisation characterise this phase. While the rational economic view assumed that people are motivated by economic gains primarily; scientific management of F.W. Taylor and others emphasised one best way of production etc; administrative theorists personified by Henri Fayol etc looked at the best way to combine jobs and people into an efficient organisation; bureaucratic organisation theorists led by Max Weber looked at ways to eliminate managerial inconsistencies due to abuse of power which contributed to ineffectiveness. This was the era of the industrial revolution and factory system of production. Large scale production would not have been possible without adherence to the principles governing organising production based on division of labour and specialisation, relationship between man and the machine, managing people and so on.

NEO CLASSICAL THEORY — HUMAN RELATIONS APPROACH

This school of thought developed between 1920s to 1950s felt that employees simply do not respond rationally to rules, chains of authority and economic incentives alone but are also guided by social needs, drives and attitudes. Hawthorne Studies at GEC etc., were conducted then. It was quite natural that in the early phases of the industrial revolution, the emphasis was on development of techniques and technology. The attention to the human factor was the salient aspect of this school of thought. This attention was to serve as a precursor to the development of behavioural sciences.

BEHAVIOURAL SCIENCE APPROACH — ORGANISATIONAL HUMANISM

Organisational behaviourists like Chris Argyris; Douglas McGregor, Abraham Maslow and Fredrick Herzberg used the knowledge of psychology, sociology and anthropology to develop this approach. The underlying philosophy of organisational humanism is that individuals need to use all of their capacities and creative skills at work as well as at home.

MANAGEMENT SCIENCE/OPERATIONAL RESEARCH

It emphasises research on operations and use of quantitative techniques to aid managers to take decisions.

MODERN MANAGEMENT

It sees modern organisations as complex systems and underlies contingency approach and use of modern techniques to solve organisational and human problems.

Source: Adapted from Internet modern history source book on www.fordham.edu

of 'Scientific Management' whereas Fayol emphasised 'Administrative Principles'.

But before we go into the details of their contributions let us study the meaning of the principles of management.

Principles of Management: The Concept

A managerial principle is a broad and general guideline for decision-making and behaviour. For example while deciding about promotion of an employee one manager may consider seniority, whereas the other may follow the principle of merit.

One may distinguish principles of management from those of pure science. Management principles are not as rigid as principles of pure science. They deal with human behaviour and, thus, are to be applied creatively given the demands of the situation. Human behaviour is never static and so also technology, which affects business. Hence all the principles have to keep pace with these changes. For example, in the absence of Information and

Communications Technology (ICT), a manager could oversee only a small work force that too within a narrow geographical space. The advent of ICT has expanded the capability of the managers to preside over large business empires spread across the globe. Infosys headquarters in Bangalore boast of the Asia's largest flat screen in their conference room from where their managers can interact with their employees and customers in all parts of the world.

In developing an understanding of the meaning of principles of management, it is also useful to know what these are not. The principles of management should be distinguished from techniques of management. Techniques are procedures or methods, which involve a series of steps to be taken to accomplish desired goals. Principles are guidelines to take decisions or actions while practicing techniques. Likewise, principles should also be understood as being distinct from values. Values are something, which are acceptable or desirable. They have moral connotations. Principles are basic truths or guidelines for behaviour. Values are general rules for behaviour of individuals in society formed through common practice whereas principles of management are formed after research in work situations, which are technical in nature. However, while practicing principles of management values cannot be neglected, as businesses have to fulfil social and ethical responsibilities towards society.

Nature of Principles of Management

By nature is meant qualities and characteristics of anything. Principles are general propositions, which are applicable when certain conditions are present. These have been developed on the basis of observation and experimentation as well as personal experiences of the managers. Depending upon how they are derived and how effective they are in explaining and predicting managerial behaviour, they contribute towards the development of management both as a science and as an art. Derivation of these principles may be said to be a matter of science and their creative application may be regarded as an art. These principles lend credibility of a learnable and teachable discipline to the practice of management. As such, ascent to managerial position may not be a matter of birth, but a matter of requisite qualifications. Clearly, management principles have gained importance with increasing professionalisation of management.

These principles are guidelines to action. They denote a cause and effect relationship. While functions of management viz., Planning, Organising, Staffing, Directing and Controlling are the actions to be taken while practising management, Principles help managers to take decisions while performing these functions. The following points summarise the nature of principles of management.

(i) **Universal applicability:** The principles of management are intended to apply to all types of organisations, business as well as non-business, small as well large, public sector as well as private sector, manufacturing as well as the services sectors. However, the extent of their applicability would vary with the nature of the organisation, business activity, scale of operations and the like. For example, for greater productivity, work should be divided into small tasks and each employee should be trained to perform his/her specialised job. This principle is applicable to a government office where there is a diary/despatch clerk whose job is to receive and send mail or documents, a data entry operator whose task is to input data on the computer, a peon and an officer etc. This principle is also applicable to a limited company where there are separate departments like Production, Finance, Marketing and Research and Development etc. Extent of division of work, however, may vary from case to case.

(ii) **General guidelines:** The principles are guidelines to action but do not provide readymade, straitjacket solutions to all managerial problems. This is so because real business situations are very complex and dynamic and are a result of many factors. However, the importance of principles cannot be underestimated because even a small guideline helps to solve a given problem. For example, in dealing with a situation of conflict between two departments, a manager may emphasise the primacy of the overall goals of the organisation.

(iii) **Formed by practice and experimentation:** The principles of management are formed by experience and collective wisdom of managers as well as experimentation. For example, it is a matter of common experience that discipline is indispensable for accomplishing any purpose. This principle finds mention in management theory. On the other hand, in order to remedy the problem of fatigue of workers in the factory, an experiment may be conducted to see the effect of improvement of physical conditions to reduce stress.

(iv) **Flexibile:** The principles of management are not rigid prescriptions, which have to be followed absolutely. They are flexible and can be modified by the manager when the situation so demands. They give the manager enough discretion to do so. For example, the degree of concentration of authority (centralisation) or its dispersal (decentralisation) will depend upon the situations and circumstances of each enterprise. Moreover individual principles are like different tools serving different purposes, the manager has to decide which tool to use under what circumstances.

(v) **Mainly behavioural:** Management principles aim at influencing behaviour of human beings. Therefore, principles of management are mainly behavioural in nature. It is not that these principles do not pertain to things and phenomenon at all, it is just a matter of emphasis. Moreover, principles enable a better understanding of the relationship between human and material resources in accomplishing organisational purposes. For example, while planning the layout of a factory, orderliness would require that workflows are matched by flow of materials and movement of men.

(vi) **Cause and effect relationships:** The principles of management are intended to establish relationship between cause and effect so that they can be used in similar situations in a large number of cases. As such, they tell us if a particular principle was applied in a particular situation, what would be its likely effect. The principles of management are less than perfect since they mainly apply to human behaviour. In real life, situations are not identical. So, accurate cause and effect relationships may be difficult to establish. However,principles of management assist managers in establishing these relationships to some extent and are therefore useful. In situations of emergencies, it is desirable that someone takes charge and others just follow. But in situations requiring cross-functional expertise, such as setting up of a new factory, more participative approach to decision-making would be advisable.

(vii) **Contingent:** The application of principles of management is contingent or dependent upon the prevailing situation at a particular point of time. The application of principles has to be changed as per requirements. For example, employees deserve fair and just remuneration. But what is just and fair is determined by multiple factors. They include contribution of the employee, paying capacity of the employer and also prevailing wage rate for the occupation under consideration.

Having described the inherent qualities and characteristics of management principles, it should be easy for you to appreciate the significance of these principles in managerial decision-making. But before that you can read the following case study of 'Kiran Mazumdar Shaw' a highly successful Indian businesswoman and CEO of 'Biocon' in the accompanying box. You should be able to see how she was able to transform a little known sector of biotechnology into a very profitable company and earn titles which any one would dream of.

From the foregoing story it is clear that success of Biocon due to the efforts of Dr. Kiran Mazumdar Shaw was not a mere chance. It was a sincere effort, which involved application of qualities, which are

The story of Dr. Kiran Mazumdar Shaw is very inspiring. She foresaw the tremendous potential of biotechnology when no one dared to think about it. She started her own company Biocon India in her garage with a meagre capital of Rs 10,000 in collaboration with Biocon Biochemicals limited of Ireland.

When she wanted to take loans no financial institution was willing to help her because of three reasons: biotechnology was a new area of operation; her company lacked assets and thirdly women entrepreneurs were a rarity at that time in 1978. She even faced problems recruiting people. The initial operation of the company consisted of extracting an enzyme from papaya.

Now Biocon limited is an integrated biotechnology enterprise focused on the development of biopharmaceuticals, custom research, clinical research and enzymes. It delivers products and solutions to partners and customers in over 50 countries.

According to the company's website, "At Biocon our success has been our ability to develop innovative technologies and products and to leverage them to adjacent domains. This unique 'integrated innovation' approach has yielded a host of patented products and technologies that have enabled multilevel relationships with our global clientele". It has two subsidiary companies. The first one is Syngene International Private limited, which provides chemistry and molecular based custom research services in early stage drug discovery and development. The second subsidiary company is Clinigene International Private Limited, which conducts longitudinal research in diabetes and offers a wide range of comprehensive services in drug development and clinical trials. Biocon was the first biotechnology company of India to receive ISO 9001 certification.

Biocon Limited is what it is today due to adherence to the principles underlying good management practices.

Adapted from www.biocon.com and other sources a part of management principles directly or indirectly. Now you can see the significance of these principles.

Significance of Principles of Management

The principles of management derive their significance from their utility. They provide useful insights to managerial behaviour and influence managerial practices. Managers may apply these principles to fulfil their tasks and responsibilities. Principles guide managers in taking and implementing decisions. It may be appreciated that everything worthwhile is governed by an underlying principle. The quest of the management theorists has been and should be to unearth the underlying principles with a view to using these under repetitive circumstances as a matter of management habit. The significance of principles of management can be discussed in terms of the following points:

(i) **Providing managers with useful insights into reality:** The principles of management provide the managers with useful insights into real world situations. Adherence to these principles will add to their knowledge, ability and understanding of managerial situations and circumstances. It will also enable managers to learn from past mistakes and conserve time by solving recurring problems quickly. As such management principles increase managerial efficiency. For example, a manager can leave routine decision-making to his subordinates and deal with exceptional situations which require her/his expertise by following the principles of delegation.

(ii) **Optimum utilisation of resources and effective administration:** Resources both human and material available with the company are limited. They have to be put to optimum use. By optimum use we mean that the resources should be put to use in such a manner that they should give maximum benefit with minimum cost. Principles equip the managers to foresee the cause and effect relationships of their decisions and actions. As such the wastages associated with a trial-and-error approach can be overcome. Effective administration necessitates impersonalisation of managerial conduct so that managerial power is used with due discretion. Principles of management limit the boundary of managerial discretion so that their decisions may be free from personal prejudices and biases. For example, in deciding the annual budgets for different departments, rather than personal preferences, managerial discretion is bounded by the principle of contribution to organisational objectives.

(iii) **Scientific decisions:** Decisions must be based on facts, thoughtful and justifiable in terms of the intended purposes. They must be timely, realistic and subject to measurement and evaluation. Management principles help in thoughtful decision-making. They emphasise logic rather than blind faith. Management decisions taken on the basis of principles are free from bias and prejudice. They are based on the objective assessment of the situation.

(iv) **Meeting changing enviornment requirements:** Although the principles are in the nature of general guidelines but they are modified and as such help managers to meet changing requirements of the environment. You have already studied that management principles are flexible to adapt to dynamic business environment. For example, management principles emphasise division of work and specialisation. In modern times this principle has been extended to the entire business whereby companies are specialising in their core competency and divesting non-core businesses. In this context, one may cite the decision of Hindustan Lever Limited in divesting non-core businesses of chemicals and seeds. Some companies are outsourcing their non-core activities like share-transfer management and advertising to outside agencies. So much so, that even core processes such as R&D, manufacturing and marketing are being outsourced today. Haven't you heard of proliferation of 'Business Process Outsourcing' (BPO) and 'Knowledge Process Outsourcing' (KPO)?

(v) **Fulfilling social responsibility:** The increased awareness of the public, forces businesses especially limited companies to fulfill their social responsibilities. Management theory and management principles have also evolved in response to these demands. Moreover, the interpretation of the principles also assumes newer and contemporary meanings with the change in time. So, if one were to talk of 'equity' today, it does not apply to wages alone. Value to the customer, care for the environment, dealings with business associates would all come under the purview of this principle. As an application of this principle, we find that Public Sector Undertakings have developed entire townships as, for example, BHEL has developed Ranipur in Hardwar

(Uttaranchal). One may also cite the story of Shri Mahila Griha Udyog Lijjat Papad as can be seen in the accompanying box on page 41.

(vi) **Management training, education and research:** Principles of management are at the core of management theory. As such these are used as a basis for management training, education and research. You must be aware that entrance to management institutes is preceded by management aptitude tests. Do you think that these tests could have been developed without an understanding of management principles and how they may be applied in different situations? These principles provide basic groundwork for the development of management as a discipline. Professional courses such as MBA (Master of Business Administration), BBA (Bachelor of Business Administration) also teach these principles as part of their curriculum at the beginner's level.

These principles enable refinement of management practices as well by facilitating the development of new management techniques. Thus, we see that techniques like Operations Research (OR), cost accounting, 'Just in Time', 'Kanban' and 'Kaizen' have developed due to further research on these principles.

In conclusion it can be said that understanding the meaning, nature and significance of principles of management will help us to appreciate their applicability in real life situations.

As stated at the beginning of the chapter, management principles have undergone a long history of evolution. And, they continue to evolve. What follows is a description of the management principles pertaining to the classical school; more precisely, those propounded by F.W. Taylor and Henri Fayol.

Taylor's Scientific Management

Scientific management refers to an important stream of one of the earlier

Test Your Understanding

1. Do you think innovativeness evident from the examples of Toyota and Kiran Mazumdar Shaw can be linked to the nature of management principles?
2. To what aspects of the significance of management principles would you attribute the endeavours of BHEL and Shri Mahila Griha Udyog Lijjat Papad?

Shri Mahila Griha Udyog Lijjat Papad – Combining Business with Social Responsibility (An Organisation Of the Women, By the Women and For the Women)

The story of Shri Mahila Griha Udyog lijjat Papad is very inspiring for would be managers. It shows how an organisation can combine business with social responsibility and make its stakeholders self-reliant. The stakeholders are various women who, numbering over 40,000, are given the task of making lijjat papads, which are famous for their quality throughout the world. The organisation which started with a modest loan of Rs 80 now has a turnover of over Rs 301 crores. Its exports exceed Rs 10 crores. The profits are distributed to the stakeholders in proportion to their contribution. It has struck to its core values for over 40 years. It has shown how it is possible to combine Gandhian values with business. The company has at least 61 branches. Any woman subscribing to these core values can become a member of the organisation. According to the website of the organisation www.lijjat.com, Shri Mahila Griha Udyog Lijjat Papad is synthesis of three different concepts (core values) namely:

1. The concept of business
2. The concept of family
3. The concept of devotion

All these concepts are completely and uniformly followed in this institution. As a result of this synthesis, a peculiar Lijjat way of thinking has developed therein.

The institution has adopted the concept of business from the very beginning. All its dealings are carried out on a sound and pragmatic footing-production of quality goods and at reasonable prices. It has never and nor will it in the future accept any charity, donation, gift or grant from any quarter. On the contrary, the member-sisters donate collectively for good causes from time-to-time according to their capacity.

Besides the concept of business, the institution along with all its member-sisters has adopted the concept of mutual family affection, concern and trust. All the affairs of the institution are dealt with in a manner similar to that of a family carrying out its own daily household chores.

But the most important concept adopted by the institution is the concept of devotion. For the member-sisters, employees and well-wishers, the institution is never merely a place to earn one's livelihood — it is a place of worship to devote one's energy not for his or her own benefits but for the benefit of all. In this institution work is worship. The institution is open to everybody who has faith in its basic concepts.

Source: Adapted from http/www.lijjat.com/organisation/core value schools of thought of management referred to as the 'Classical' school. The other two streams belonging to the classical school are Fayol's Administrative Theory and Max Weber's Bureaucracy. We will not be describing bureaucracy here. A discussion of Fayol's principles, however, will follow the discussion of scientific management.

Fredrick Winslow Taylor (March 20,1856 – March 21, 1915) was an American mechanical engineer who sought to improve industrial efficiency. In 1874, he became an apprentice mechanist, learning factory conditions at the grass roots level. He earned a degree in mechanical engineering. He was one of the intellectual leaders of the efficiency movement and was highly influential in reshaping the factory system of production. You must appreciate that he belonged to the era of the industrial revolution characterised by mass production.

Fredrick Winslow Taylor – Founder of Scientific Management Movement

LIFE TIME: March 20,1856 to March 21, 1915
PROFESSION: American mechanical engineer
EDUCATION: Degree in Mechanical Engineering from Stevens Institute of Technology in 1883.
POSITIONS HELD—

1. Apprentice Machinist in 1874.
2. Executive at Midville Steel Company in 1884.
3. At Bethlehem Iron Company in 1898, which later became Bethlehem Steel Company.
4. Professor at 'Tuck School of Business' founded in 1900.
5. President of 'American Society of Mechanical Engineers' from 1906 to 1907.

WRITINGS: 1. 'The Principles of Scientific Management' series of articles published in 'The American Magazine'
During march-may 1911, later published in book form.

1. 'Concrete, Plain and Reinforced' in 1906.
2. 'Notes on Belting' in 1893
3. 'On the Art of Cutting Metals' December 1906.
4. 'A Piece Rate System' in June 1895.
5. 'The making of a putting green' a series of articles published in 1915.
6. 'Not for the genius but for the average man' published in 'The American Magazine' in March 1918.

Adapted from www.wikipedia.org and www.stevens.edu/library

You must also appreciate that every new development takes some time to be perfected. Taylor's contribution must be seen in the light of the efforts made to perfect the factory system of production.

Taylor thought that by scientifically analysing work, it would be possible to find 'one best way' to do it. He is most remembered for his time and motion studies. He would break a job into its component parts and measure each to the second.

Taylor believed that contemporary management was amateurish and should be studied as a discipline. He also wanted that workers should cooperate with the management and thus there would be no need of trade unions. The best results would come from the partnership between a trained and qualified management and a cooperative and innovative workforce. Each side needed the other.

He is known for coinage of the term 'Scientific Management' in his article 'The Principles of Scientific Management' published in 1911. After being fired from Bethlehem Steel Company he wrote a book 'Shop floor' which sold well. He was selected to be the president of the American Society of Mechanical Engineers (ASME) from 1906 to 1907. He was a professor at Tuck School of Business at Dartmouth College founded in 1900.

In 1884 he became an executive at Midvale Steel Company by demonstrating his leadership abilities. He instructed his fellow workers to work in phases. He joined the Bethlehem Iron Company in 1898, which later became Bethlehem Steel Company. He was originally employed to introduce piece rate wage system. After setting up the wage system, he was given authority and more responsibilities in the company. Using his newfound resources he increased the staff and made Bethlehem a show place for inventive work. Unfortunately, the company was sold to another group and he was discharged.

In 1910 his health started to fall. He died in 1915 due to pneumonia. A synoptic view of his contribution can be had from the accompanying box on the next page.

Principles of Scientific Management

In the earlier days of the Industrial Revolution, in the absence of an established theory of factory organisation, factory owners or managers relied on personal judgment in attending to the problems they confronted in the course of managing their work. This is what is referred to as 'rule of thumb'. Managing factories by rule of thumb enabled them to handle the situations as they arose but suffered from the limitation of a trial and error approach. For their experiences to be emulated, it was important to know what works and why does it work. For this, there was

Taylor's Contribution to Scientific Management

The following extracts are taken from Taylor's testimony before the U.S. House of Representatives Special Committee in 1912 and also from his most important work "THE PRINCIPLES OF SCIENTIFIC MANAGEMENT" published in 1911.

"Scientific management requires first, a careful investigation of each of the many modifications of the same implement, developed under rule of thumb; and second, after time and motion study has been made of the speed attainable with each of these implements, that the good points of several of them shall be unified in a single standard implementation, which will enable the workman to work faster and with greater ease than he could before. This one implement, then is adopted as standard in place of the many different kinds before in use and it remains standard for all workmen to use until superseded by an implement which has been shown, through motion and time study, to be still better." (Scientific management, page 119)

The main elements of the Scientific Management are: (page 129-130 sci-mgt) "Time Studies"

Functional or specialised supervision
Standardisation of tools and implements
Standardisation of work methods
Separate Planning function
Management by exception principle
The use of 'slide-rules and similar time-saving devices'
Instruction cards for workmen
Task allocation and large bonus for successful performance
The use of the 'differential rate'
Mnemonic systems for classifying products and implements
A routing system
A modern costing system etc. etc.

Taylor called these elements "merely the elements or details of the mechanisms of management" He saw them as extensions of the four principles of management. (Page 130, scientific management)

1. The development of a true science.
2. The scientific selection of the workman.
3. The scientific education and development of the workman.
4. Intimate and friendly cooperation between the management and the employees.

Adapted from Taylorism (F.W. Taylor & Scientific Management) at http://www.quality.org/TQM-MSI/taylor.html a need to follow an approach that was based on the method of science-defining a problem, developing alternative solutions, anticipating consequences, measuring progress and drawing conclusions.

In this scenario, Taylor emerged as the 'Father of Scientific Management'. He proposed scientific management as opposed to rule of thumb. He broke up human activity into small parts and found out how it could be done effectively, in less time and with increased productivity. It implies conducting business activities according to standardised tools, methods and trained personnel in order to increase the output, improve its quality and reduce costs and wastes.

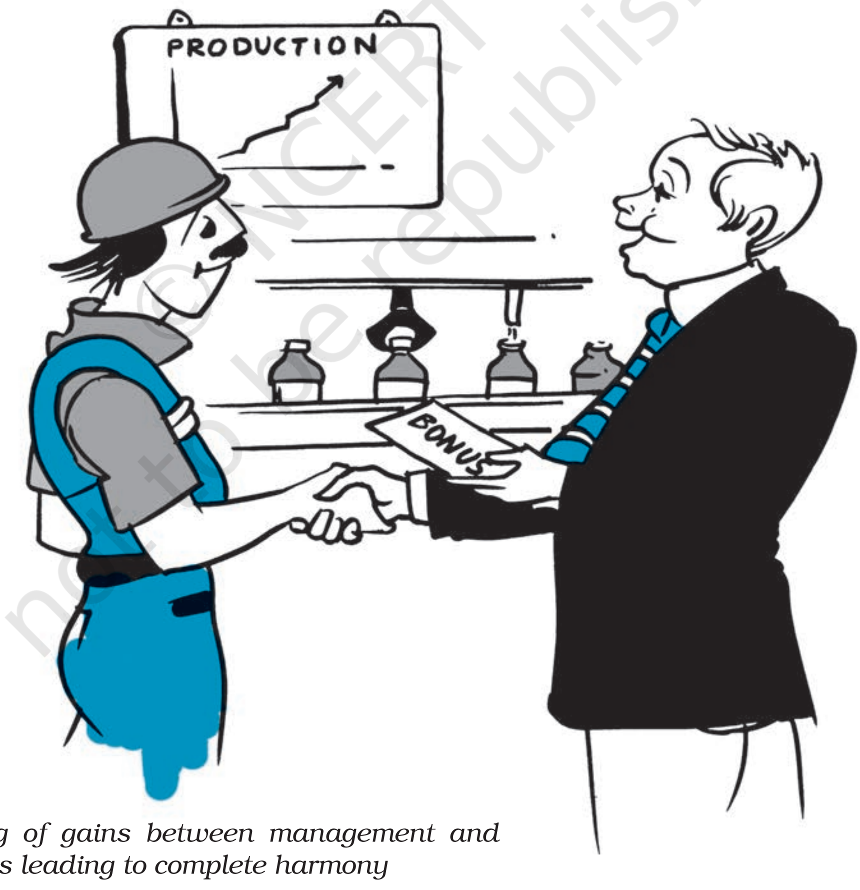
In the words of Taylor, "Scientific management means knowing exactly what you want men to do and seeing that they do it in the best and cheapest way. The Bethlehem Steel company where Taylor himself worked achieved three-fold increase in productivity by application of scientific management principles. Therefore, it would be in order to discuss these principles.

(i) **Science not Rule of Thumb:** Taylor pioneered the introduction of the method of scientific inquiry into the domain of management practice. We have already referred to the limitations of the rule of thumb approach of management. As different managers would follow their indigenous rules of thumb, it is but a statement of the obvious that all would not be equally effective. Taylor believed that there was only one best method to maximise efficiency. This method can be developed through study and analysis. The method so developed should substitute 'Rule of Thumb' throughout the organisation. Scientific method involved investigation of traditional methods through work-study, unifying the best practices and developing a standard method, which would be followed throughout the organisation. According to Taylor, even a small production activity like loading pigs of iron into boxcars can be scientifically planned and managed. This can result in tremendous saving of human energy as well as wastage of time and materials. The more sophisticated the processes, greater would be the savings.

In the present context, the use of internet has brought about dramatic improvements in internal efficiencies and customer satisfaction.

(ii) **Harmony, Not Discord:** Factory system of production implied that managers served as a link between the owners and the workers. Since as managers they had the mandate to 'get work done' from the workers, it should not be difficult for you to appreciate that there always existed the possibility of a kind of class-conflict, the mangers versus workers. Taylor recognised that this conflict helped none, the workers, the managers or the factory owners. He emphasised that there should be complete harmony between the management and workers. Both should realise that each one is important. To achieve this state, Taylor called for complete mental revolution on the part of both management and workers. It means that management and workers should transform their thinking. In such a situation even trade unions will not think of going on strike etc.

Management should share the gains of the company, if any, with the workers. At the same time workers should work hard and



Sharing of gains between management and workers leading to complete harmony be willing to embrace change for the good of the company. Both should be part of the family. According to Taylor, 'Scientific management has for its foundation the firm conviction that the true interests of the two are one and the same; that prosperity for the employer cannot exist for a long time unless it is accompanied by prosperity for the employees and vice versa'.

Japanese work culture is a classic example of such a situation. In Japanese companies, paternalistic style of management is in practice. There is complete openness between the management and workers. If at all workers go to strike they wear a black badge but work more than normal working hours to gain the sympathy of the management.

(iii) **Cooperation, Not Individualism:** There should be complete cooperation between the labour and the management instead of individualism. This principle is an extension of principle of 'Harmony not discord'. Competition should be replaced by cooperation. Both should realise that they need each other.

For this, management should not close its ears to any constructive suggestions made by the employees. They should be rewarded for their suggestions which results in substantial reduction in costs. They should be part of management and, if any important decisions are taken, workers should be taken into confidence.

At the same time workers should desist from going on strike and making unreasonable demands on the management. In fact when there will be open communication system and goodwill there will be no need for even a trade union. Paternalistic style of management, whereby the employer takes care of the needs of employees, would prevail as in the case of Japanese companies.

According to Taylor, there should be an almost equal division of work and responsibility between workers and management. All the day long the management should work almost side by side with the workers helping, encouraging and smoothing the way for them.

(iv) **Development of Each and Every Person to His or Her Greatest Efficiency and Prosperity:** Industrial efficiency depends to a large extent on personnel competencies. As such, scientific management also stood for worker development. Worker training was essential also to learn the 'best method' developed as a consequence of the scientific approach. Taylor was of the view that the concern for efficiency could be built in right from the process of employee selection. Each person should be scientifically selected. Then work assigned should suit her/his physical, mental and intellectual capabilities. To increase efficiency, they should be given the required training. Efficient employees would produce more and earn more. This will ensure their greatest efficiency and prosperity for both company and workers.

From the foregoing discussion it is clear that Taylor was an ardent supporter of use of scientific method of production in business.

Techniques of Scientific Management

Let us now discuss techniques as specified by him. These are based on the various experiments he conducted during his career.

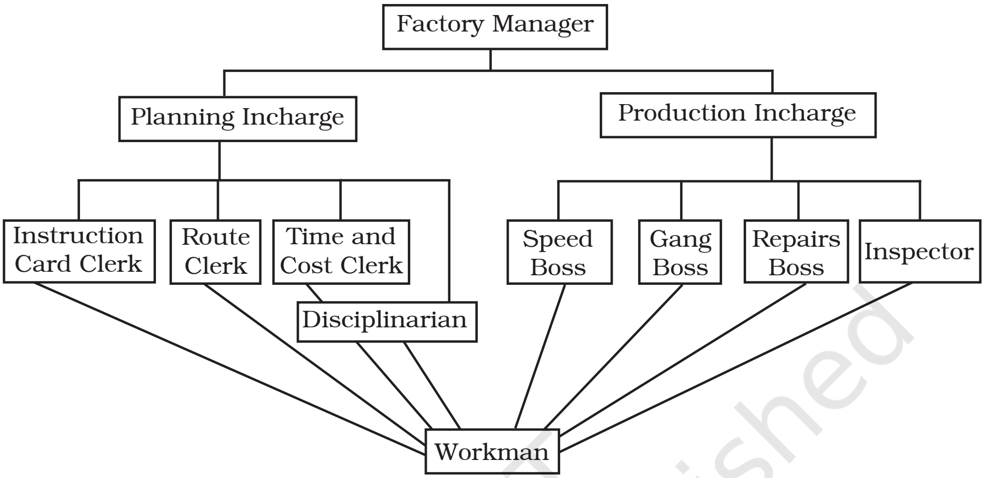
Functional Foremanship

In the factory system, the foreman represents the managerial figure with whom the workers are in face-to-face contact on a daily basis. In the first chapter of the book, you have seen that the foreman is the lowest ranking manager and the highest ranking worker. He is the pivot around whom revolves the entire production planning, implementation and control. Thus, Taylor concentrated on improving the performance of this role in the factory set-up. In fact, he identified a list of qualities of a good foreman/supervisor and found that no single person could fit them all. This prompted him to suggest functional foremanship through eight persons.

Taylor advocated separation of planning and execution functions. This concept was extended to the lowest level of the shop floor. It was known as functional foremanship. Under the factory manager there was a planning incharge and a production incharge. Under planning incharge four personnel namely instruction card clerk, route clerk, time and cost clerk and a disciplinarian worked. These four personnel would draft instructions for the workers, specify the route of production, prepare time and cost sheet and ensure discipline respectively.

Under Production incharge, personnel who would work were speed boss, gang boss, repair boss, and inspector. These respectively were responsible for timely and accurate completion of job, keeping machines and tools etc., ready for operation by workers, ensure proper working condition of machines and tools and check the quality of work.

Functional foremanship is an extension of the principle of division of work and specialisation to the shop floor. Each worker will have to



take orders from these eight foremen in the related process or function of production. Foremen should have intelligence, education, tact, grit, judgment, special knowledge, manual dexterity, and energy, honesty and good health. Since all these qualities could not be found in a single person so Taylor proposed eight specialists. Each specialist is to be assigned work according to her/his qualities. For example, those with technical mastery, intelligence and grit may be given planning work. Those with energy and good health may be assigned execution work.

Standardisation and Simplification of Work

Taylor was an ardent supporter of standardisation. According to him scientific method should be used to analyse methods of production prevalent under the rule of thumb. The best practices can be kept and further refined to develop a standard which should be followed throughout the organisation. This can be done through work-study techniques which include time study, motion study, fatigue study and method study, and which are discussed further in this chapter. It may be pointed out that even the contemporary techniques of business process including reengineering, kaizen (continuous improvement) and benchmarking are aimed at standardising the work.

Standardisation refers to the process of setting standards for every business activity; it can be standardisation of process, raw material, time, product, machinery, methods or working conditions. These standards are the benchmarks, which must be adhered to during production. The objectives of standardisation are:

(i) To reduce a given line or product to fixed types, sizes and characteristics.
(ii) To establish interchange ability of manufactured parts and products.
(iii) To establish standards of excellence and quality in materials.
(iv) To establish standards of performance of men and machines.

Simplification aims at eliminating superfluous varieties, sizes and dimensions while standardisation implies devising new varieties instead of the existing ones. Simplification aims at eliminating unnecessary diversity of products. It results in savings of cost of labour, machines and tools. It implies reduced inventories, fuller utilisation of equipment and increasing turnover.

Most large companies like Nokia, Toyota and Microsoft etc. have successfully implemented standardisation and simplification. This is evident from their large share in their respective markets.

Method Study

The objective of method study is to find out one best way of doing the job. There are various methods of doing the job. To determine the best way there are several parameters. Right from procurement of raw materials till the final product is delivered to the customer every activity is part of method study. Taylor devised the concept of assembly line by using method study. Ford Motor Company used this concept very successfully. Even now auto companies are using it.

The objective of the whole exercise is to minimise the cost of production and maximise the quality and satisfaction of the customer. For this purpose many techniques like process charts and operations research etc are used.

For designing a car, the assembly line production would entail deciding the sequence of operations, place for men, machines and raw materials etc. All this is part of method study.

Motion Study

Motion study refers to the study of movements like lifting, putting objects, sitting and changing positions etc., which are undertaken while doing a typical job. Unnecessary movements are sought to be eliminated so that it takes less time to complete the job efficiently. For example, Taylor and his associate Frank Gailberth were able to reduce motions in brick layering from 18 to just 5. Taylor demonstrated that productivity increased to about four times by this process.

On close examination of body motions, for example, it is possible to find out:

(i) Motions which are productive
(ii) Motions which are incidental (e.g., going to stores)
(iii) Motions which are unproductive.

Taylor used stopwatches and various symbols and colours to identify different motions. Through motion studies, Taylor was able to design suitable equipment and tools to educate workers on their use. The results achieved by him were truly remarkable.

Time Study

It determines the standard time taken to perform a well-defined job. Time measuring devices are used for each element of task. The standard time is fixed for the whole of the task by taking several readings. The method of time study will depend upon volume and frequency of the task, the cycle time of the operation and time measurement costs. The objective of time study is to determine the number of workers to be employed; frame suitable incentive schemes and determine labour costs.

For example, on the basis of several observations it is determined that standard time taken by the worker to make one cardboard box is 20 minutes. So in one hour she/he will make 3 boxes. Assuming that a worker has to put in 8 hours of work in a shift and deducting one hour for rest and lunch, it is determined that in 7 hours a worker makes 21 boxes @ 3 boxes per hour. Now this is the standard task a worker has to do. Wages can be decided accordingly.

Fatigue Study

A person is bound to feel tired physically and mentally if she/he does not rest while working. The rest intervals will help one to regain stamina and work again with the same capacity. This will result in increased productivity. Fatigue study seeks to determine the amount and frequency of rest intervals in completing a task. For example, normally in a plant, work takes place in three shifts of eight hours each. Even in a single shift a worker has to be given some rest interval to take her/his lunch etc. If the work involves heavy manual labour then small pauses have to be frequently given to the worker so that she/he can recharge her/his energy level for optimum contribution.

There can be many causes for fatigue like long working hours, doing unsuitable work, having uncordial relations with the boss or bad working conditions etc. Such hindrances in good performance should be removed.

Differential Piece Wage System

Taylor was a strong advocate of piece wage system. He wanted to differentiate between efficient and inefficient workers. The standard time and other parameters should be determined on the basis of the work-study discussed above. The workers can then be classified as efficient or inefficient on the basis of these standards. He wanted to reward efficient workers. So he introduced different rate of wage payment for those who performed above standard and for those who performed below standard. For example, it is determined that standard output per worker per day is 10 units and those who made standard or more than standard will get Rs. 50 per unit and those below will get Rs. 40 per unit. Now an efficient worker making 11 units will get 11×50= Rs. 550 per day whereas a worker who makes 9 units will get 9×40 = Rs. 360 per day.

According to Taylor, the difference of Rs. 190 should be enough for the inefficient worker to be motivated to perform better. From his own experience, Taylor gives the example of a worker named Schmidt who was able to earn 60% more wages from $1.15 to $1.85 on increasing pig iron loading from 12.5 tons per man per day to 47 tons per man per day in box cars at Bethlehem Steel works by following scientific management techniques.

It is important to have a relook at the techniques of scientific management as comprising a unified whole of Taylor's prescription of efficiency. Search for efficiency requires the search for one best method and the chosen method must lead to the determination of a fair day's work. There must be a compensation system that differentiates those who are able to accomplish/exceed the fair day's work. This differential system must be based on the premise that efficiency is the result of the joint efforts of the managers and the workers. Thus, rather than quarrelling over the share in the resultant surplus, the workers and managers should work in harmony for maximising the output rather than restricting it. Clearly the sum and substance of Taylor's ideas lies not in the disjointed description of principles and techniques of scientific management, but in the change of the mindset, which he referred to as **mental revolution**. Mental revolution involves a change in the attitude of workers and management towards one another from competition to cooperation. Both should realise that they require one another. Both should aim to increase the size of surplus. This would eliminate the need for any agitation. Management should share a part of surplus with workers. Workers should also contribute their might so that the company makes profits. This attitude will be good for both of them and also for the company. In the long run only worker's well-being will ensure prosperity of the business.

Now, having studied the elements, principles and techniques of scientific management we can consider the practical applications of the same at the time of F.W. Taylor and in the present.

We can also examine the present status of scientific management. Today, many new techniques have been developed as a sequel to scientific management. Operations research was developed in the second World War to optimise the deployment of war material. Similarly assembly line was also discovered by F.W. Taylor, which was used very successfully by Ford motor company for manufacturing 'Model T' car for the masses. This concept is much used now. The latest development in scientific management is 'LEAN MANUFACTURING'. Now a days robotics and computers are being used in production and other business activities. This is part of scientific management of these activities. It has increased productivity levels. The techniques of operation research have also been developed and are being used as a result of scientific management. The box below gives meanings of some terms used in modern manufacturing.

Fayol's Principles of Management

In the development of classical school of management thought, Fayol's administrative theory provides an important link. While Taylor succeeded in revolutionising the working of factory shop-floor in terms of devising the best method, fair day's work, differential piece-rate system and functional foremanship; Henri Fayol explained what amounts to a managers work and what principles should be followed in doing this work. If workers' efficiency mattered in the factory system, so does the managerial efficiency. Fayol's contribution must

Applications of Scientific Management by Taylor and his Contemporaries

1. Taylor found out the optimum-shovelling load of 21 pounds per shovel per worker through a series of experiments in work-study at Bethlehem Steel Company. The implementation saved the company $ 75000 to $80000 per year.
2. Pig iron handling per person per day was increased from 12.5 tons to 47 tons. This also resulted in the wages increase to labourers by 60% but also savings to the company on account of less number of labourers from 500 to 140.
3. He had published a paper "The Art of cutting metals" which turned it into a science.
4. He designed a Piece Rate Wage System including incentives for Bethlehem Steel Company.
5. Taylor's associate Frank Gilbreth applied scientific management to the art of 'brick layering' and through motion study was able to eliminate certain motions which were considered by the brick layers to be necessary (reduced motions from 18 to 5), designed simple apparatus like adjustable scaffold and its packets to hold the bricks and finally also taught brick layers to use both the hands at the same time. This is a classic example of application of Scientific Management to the simple art of brick layering.

be interpreted in terms of the impact that his writings had and continue to have improvement in managerial efficiencies.

Henri Fayol (1841-1925) was a French management theorist whose theories concerning scientific organisation of labour were widely influential in the beginning of twentieth century. He graduated from the mining academy of St. Etienne in 1860 in mining engineering. The

Glossary of Some Terms of Modern Production/Scientific Management

1. Just In Time Manufacturing: It is an inventory management strategy to improve return on investment by reducing in process inventory and its associated costs. The system is implemented by the use of visual signals or KANBAN, which tells whether the replenishment is required at any level of production process, or not.
2. Lean Manufacturing: It is a management philosophy focusing on reduction of seven wastes of overproduction, waiting time, transportation, processing, motion, inventory and scrap in any type of manufacturing process or any type of business. By eliminating waste, quality is improved, production time is reduced and cost is reduced.
3. Kaizen: It is a Japanese word, which means 'change for better' or 'improvement'. It is an approach to improvement of productivity through application of works of American experts such as F.W. Taylor by Japanese after World War II. The goals of kaizen include elimination of waste (which is defined as those activities which add cost but not value to the product or service), just in time delivery, production load levelling of amount and types, standardised work, paced moving lines, right sized equipment and others. A closer Japanese use of the word means 'to take apart and put it in a better way'. What is taken apart is usually a process, system, product or service. It is a daily activity which humanizes the workplace, eliminates hard work both physical and mental, teaches people how to do rapid experiments using scientific method and how to learn to see and eliminate waste in business processes.
4. Six Sigma: It is a data driven approach that can help any organisation-whatever sector or field it might be operating in, to bring down inefficiencies and save time and money by reducing 'quality variations'. It has a strong customer oriented approach that relies on data to create more efficient processes or refine existing processes. There should not be more than 3-4 defects per million opportunities according to prescribed norms. It can be applied to any process but needs unstilted organisational support.

Test Your Understanding

Suppose you want to set up a small-scale industry to manufacture stationery items. What steps would you take to implement scientific management? Identify the elements of scientific management you would like to implement and list the benefits it would give.

19 year old engineer started at the mining company 'Compagnie de commentary-Fourchambean-Decazeville, ultimately acting as its managing director from 1888 to 1918.

His theories deal with organisation of production in the context of a competitive enterprise that has to control its production costs. Fayol was the first to identify four functions of management – Planning, Organising, Directing and Controlling although his version was a bit different – Plan, Organise, Command, Coordinate and Control. According to Fayol, all activities of an industrial undertaking could be divided into: Technical; Commercial; Financial; Security; Accounting and Managerial. He also suggested that qualities a manager must possess should be — Physical, Moral, Education, Knowledge and experience. He believed that the number of management principles that might help to improve an organisation's operation is potentially limitless.

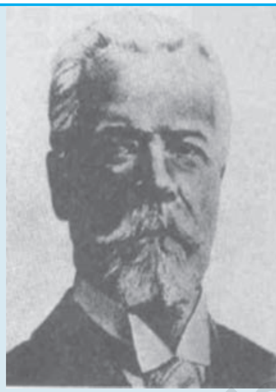
Based largely on his own experience, he developed his concept of administration. The 14 principles of management propounded by him were discussed in detail in his book published in 1917, 'Administration industrielle et generale'. It was published in English as 'General and Industrial Management' in 1949 and is widely considered a foundational work in classical management theory. For his contribution he is also known as the 'Father of General Management'

The 14 principles of management given by him are:

(i) **Division of Work:** Work is divided into small tasks/jobs. A trained specialist who is competent is required to perform each job. Thus, division of work leads to specialisation. According to Fayol, "The intent of division of work is to produce more and better work for the same effort. Specialisation is the most efficient way to use human effort."

In business work can be performed more efficiently if it is divided into specialised tasks; each performed by a specialist or trained employee. This results in efficient and effective output. Thus, in a company we have separate departments for finance, marketing, production

Henri Fayol



1. Life Time: 1841 TO 1925
2. Profession: Mining Engineer and Management Theorist (French national)
3. Education: Graduated from Mining Academy at St. Entinne. in 1880.
4. Positions Held: Founded the mining company 'Cmpagnie de Commentry- Fourchambeau-Decazeville' and became its Managing Director in 1888 and remained till 1918.
5. Writings: Administration industrielle et générale. It was published in English as General and Industrial Management in 1949 and is widely considered *a foundational work in classical management theory.*
6. Contributions: Mainly 14 Management Principles, which are referred to as administrative in nature in that they have Top-Down approach concerning top management and other manager's conduct.

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Image source: www.image.google.com

and human resource development etc. All of them have specialised persons. Collectively they achieve production and sales targets of the company. Fayol applies this principle of division of work to all kinds of work – technical as well as managerial. You can observe this principle at work in any organisation like hospital or even a government office.

(ii) **Authority and Responsibility:** According to Fayol, "Authority is the right to give orders and obtain obedience, and responsibility is the corollary of authority. The two types of authority are official authority, which is the authority to command, and personal authority which is the authority of the individual manager."

Authority is both formal and informal. Managers require authority commensurate with their responsibility. There should be a balance between authority and responsibility. An organisation should build safeguards against abuse of managerial power. At the same time a manager should have necessary authority to carry out his responsibility. For example, a sales manager has to negotiate a deal with a buyer. She finds that if she can offer credit period of 60 days she is likely to clinch the deal which is supposed to fetch the company net margin of say Rs. 50 crores. Now the company gives power to the manager to offer a credit period of only 40 days. This shows that there is an imbalance in authority and responsibility. In this case the manager should be granted authority of offering credit period of 60 days in the interest of the company. Similarly, in this example this manager should not be given a power to offer a credit period of say 100 days because it is not required. A manager should have the right to punish a subordinate for wilfully not obeying a legitimate order but only after sufficient opportunity has been given to a subordinate for presenting her/his case.

(iii) **Discipline:** Discipline is the obedience to organisational rules and employment agreement which are necessary for the working of the organisation. According to Fayol, discipline requires good superiors at all levels, clear and fair agreements and judicious application of penalties.

Suppose management and labour union have entered into an agreement whereby workers have agreed to put in extra hours without any additional payment to revive the company out of loss. In return the management has promised to increase wages of the workers when this mission is accomplished. Here discipline when applied would mean that the workers and management both honour their commitments without any prejudice towards one another.

(iv) **Unity of Command:** According to Fayol there should be one and only one boss for every individual employee. If an employee gets orders from two superiors at the same time the principle of unity of command is violated. The principle of unity of command states that each participant in a formal organisation should receive orders from and be responsible to only one superior. Fayol gave a lot of importance to this principle. He felt that if this principle is violated "authority is undermined, discipline is in jeopardy, order disturbed and stability threatened". The principle resembles military organisation. Dual subordination should be avoided. This is to prevent confusion regarding tasks to be done. Suppose a sales person is asked to clinch a deal with a buyer and is allowed to give 10% discount by the marketing manager. But finance department tells her/him not to offer more than 5% discount. Now there is no unity of command. This can be avoided if there is coordination between various departments.

(v) **Unity of Direction:** All the units of an organisation should be moving towards the same objectives through coordinated and focussed efforts. Each group of activities having the same objective must have one head and one plan. This ensures unity of action and coordination. For example, if a company is manufacturing motorcycles as well as cars then it should have two separate divisions for both of them. Each division should have its own incharge, plans and execution resources. On no account should the working of two divisions overlap. Now let us differentiate between the two principles of unity of command and unity of direction.

(vi) **Subordination of Individual Interest to General Interest:** The interests of an organisation should take priority over the interests of any one individual employee according to Fayol. Every worker has some individual interest for working in a company. The company has got its own objectives. For example, the company would want to get maximum output from its employees at a competitive cost (salary). On the other hand, an employee may want to get maximum salary while working the least. In another situation an individual employee may demand some concession, which is not admissible to any other employee like working for less time.

In all the situations the interests of the group/company will supersede the interest of any one individual. This is so because larger interests of the workers and stakeholders are more important than the interest of any one person. For example, interests of various stakeholders i.e., owners, shareholders, creditors, debtors, financers, tax authorities, customers and the society at large cannot be sacrificed for

Difference betweeen Unity of Command and Unity of Direction

Basis	Unity of Command	Unity of Direction
1. Meaning	One subordinate should receive orders from and should be responsible to only one superior.	Each group of activities having same objective must have one head and one plan.
2. Aim	It prevents dual subordination.	It prevents overlapping of activities.
3. Implications	It affects an individual employee.	It affects the entire organisation.

one individual or a small group of individuals who want to exert pressure on the company. A manager can ensure this by her/his exemplary behaviour. For example, she/he should not fall into temptation of misusing her/his powers for individual/ family benefit at the cost of larger general interest of the workers/ company. This will raise her/his stature in the eyes of the workers and at the same time ensure same behaviour by them.

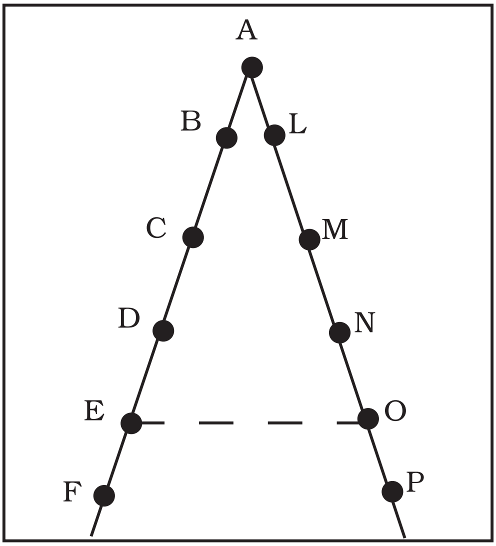
(vii) **Remuneration of Employees:** The overall pay and compensation should be fair to both employees and the organisation. The employees should be paid fair wages, which should give them at least a reasonable standard of living. At the same time it should be within the paying capacity of the company. In other words, remuneration should be just and equitable. This will ensure congenial atmosphere and good relations between workers and management. Consequently, the working of the company would be smooth.

(viii) **Centralisation and Decentralisation:** The concentration of decision-making authority is called centralisation whereas its dispersal among more than one person is known as decentralisation. According to Fayol, "There is a need to balance subordinate involvement through decentralisation with managers' retention of final authority through centralisation." The degree of centralisation will depend upon the circumstances in which the company is working. In general large organisations have more decentralisation than small organisations. For example, panchayats in our country have been given more powers to decide and spend funds granted to them by the government for the welfare of villages. This is decentralisation at the national level.

(ix) **Scalar Chain:** An organisation consists of superiors and subordinates. The formal lines of authority from highest to lowest ranks are known as scalar chain.

According to Fayol, "Organisations should have a chain of authority and communication that runs from top to bottom and should be followed by managers and the subordinates."

Let us consider a situation where there is one head 'A' who has two lines of authority under her/ him. One line consists of B-C-D-E-F. Another line of authority under 'A' is L-M-N-O-P. If 'E' has to communicate with 'O' who is at the same level of authority then she/he has to traverse the route E-D-C-B-A-L-M-N-O. This is due to the principle of scalar



Fayol's Scalar Chain

chain being followed in this situation. According to Fayol, this chain should not be violated in the normal course of formal communication. However, if there is an emergency then 'E' can directly contact 'O' through 'Gang Plank' as shown in the diagram. This is a shorter route and has been provided so that communication is not delayed. In practice you find that a worker cannot directly contact the CEO of the company. If at all she/he has to, then all the formal levels i.e., foreman, superintendent, manager, director etc have to know about the matter. However, in an emergency it can be possible that a worker can contact CEO directly.

(x) **Order:** According to Fayol, "People and materials must be in suitable places at appropriate time for maximum efficiency." The principle of order states that 'A place for everything (everyone) and everything (everyone) in its (her/his) place'. Essentially it means orderliness. If there is a fixed place for everything and it is present there, then there will be no hindrance in the activities of business/ factory. This will lead to increased productivity and efficiency.

(xi) **Equity:** Good sense and experience are needed to ensure fairness to all employees, who should be treated as fairly as possible," according to Fayol. This principle emphasises kindliness and justice in the behaviour of managers towards workers. This will ensure loyalty and devotion. Fayol does not rule out use of force sometimes. Rather he says that lazy personnel should be dealt with sternly to send the message that everyone is equal in the eyes of the management. There should be no discrimination against anyone on account of sex, religion, language, caste, belief or nationality etc. In practice we can observe that now a days in multinational corporations people of various nationalities work together in a discrimination free environment.

Equal opportunities are available for everyone in such companies to rise. Thus, we find India-born CEO's such as Rajat Gupta who heads multinational like Mckinsey Inc. Lately India-born American Arun Sarin has become CEO of Vodaphone limited, a British telecom major.

(xii) **Stability of Personnel:** "Employee turnover should be minimised to maintain organisational efficiency", according to Fayol. Personnel should be selected and appointed after due and rigorous procedure. But once selected they should be kept at their post/ position for a minimum fixed tenure. They should have stability of tenure. They should be given reasonable time to show results. Any adhocism in this regard will create instability/insecurity among employees. They would tend to leave the organisation. Recruitment, selection and

Employee suggestion system: Encourage initiative among trainee managers

Fayol: Then and Now

Now let us see what Fayol's principles means in the contemporary business situations especially service based and high tech economies like USA. Carl A. Rodrigues of Mont Clair State University, Upper Montclair, New Jersey, USA has come out with the following conclusions in his paper "Fayol's 14 Principles of Management. Then and Now- A Framework For Managing Today's Organisations Effectively" published in Journal "Management Decision" 39/10(2001) PP 880-889.

	Name of Principle	THEN	NOW
1.	Division of Work	Specialisation in workers Job design	Generalisation in workers' Job design
2.	Authority & Responsibility	Managers are empowered	Employees are empowered
3.	Discipline	Formalised Controls	Informal, Peer pressure controls
4.	Unity of Command	Subordinates report to only one boss	Subordinates report to multiple bosses
5.	Unity of Direction	Functions have only one plan and one boss	Functions have multiple plans and multiple bosses
6.	Subordination of individual interest to common good	Employees are committed to the organisation	Organisation is committed to the employees and vice versa
7.	Remuneration of personnel	Reasonable Pay reward system	Performance based reward system
8.	Centralisation	Trickle down decision making	Task relevant ad hoc decision making
9.	Scalar Chain	Hierarchical, formalised communication channel	Less formalised, flatter communication structure.
10.	Order	Internal information system for control purposes	Internal information system for coordination purposes.
11.	Equity	Commitment obtained through kindness	Commitment obtained through a sense of ownership
12.	Stability of tenure of personnel	Train employees and encourage them to remain	On-going employee training and development
13.	Initiative	Managers conceive and implement new ideas	Workers conceive and implement new ideas
14.	Espirit de corps	Maintaining high morale among employees is imperative	Maintaining high morale among employees is desirable.

training cost will be high. So stability in tenure of personnel is good for the business.

(xiii) **Initative:** Workers should be encouraged to develop and carry out their plans for improvements according to Fayol. Initiative means taking the first step with self-motivation. It is thinking out and executing the plan. It is one of the traits of an intelligent person. Initiative should be encouraged. But it does not mean going against the established practices of the company for the sake of being different. A good company should have an employee suggestion system whereby initiative/ suggestions which result in substantial cost/time reduction should be rewarded.

(xiv) **Espirit De Corps:** Management should promote a team spirit of unity and harmony among employees, according to Fayol. Management should promote teamwork especially in large organisations because otherwise objectives would be difficult to realise. It will also result in a loss of coordination. A manager should replace 'I' with 'We' in all his conversations with workers to foster team spirit. This will give rise to a spirit of mutual trust and belongingness among team members. It will also minimise the need for using penalties.

From the foregoing discussion it is clear that Fayol's 14 principles of management are widely applicable to managerial problems and have cast a profound impact on management thinking today. But with the change of environment in which business is done, the interpretation of these principles has changed. For example, authority and responsibility meant empowering of managers but now it means empowerment of employees because of flat organisational structures that are gaining ground. We are now in a position to understand the current connotations of Fayol's principles discussed in the accompanying box.

Fayol Versus Taylor — A Comparison

We are now in a position to compare the contributions of both Fayol and Taylor. Both of them have contributed immensely to the knowledge of management, which has formed a basis for further practice by managers. It must be pointed out that their contributions are complementary to each other. We can make out the following points of difference between their contributions.

You may also like to have some knowledge of contributions of Indians to the growth of management knowledge which can be seen in the accompanying box item.

Sl. No.	Basis of difference	Henri Fayol	F. W. Taylor
1.	Perspective	Top level of management	Shop floor level of a factory
2.	Unity of Command	Staunch Proponent	Did not feel that it is important as under functional foremanship a worker received orders from eight specialists.
3.	Applicability	Applicable universally	Applicable to specialised situations
4.	Basis of formation	Personal experience	Observations and experimentation
5.	Focus	Improving overall administration	Increasing Productivity
6.	Personality	Practitioner	Scientist
7.	Expression	General Theory of Administration	Scientific Management

Rise of Indian Management Gurus

While we have been reading about American management gurus like Peter Ducker, Edward Peter, F.W. Taylor and Henry Fayol, lately Indians have made their mark on the international management scene.

The Top 50 thinkers list for 2005 named as many as four Indians — strategy guru C K Prahalad, itinerant executive coach Ram Charan, Tuck Business School professor Vijay Govindrajan and Rakesh Khurana of Harvard Business School (HBS). London Business School's Sumantra Ghoshal, who is the author of Managing Across Borders: The Transnational Solution which made it to Financial Times' list of the twentieth century's 50 most influential books, would also have made it. Not to mention a marquee of superstars like Nitin Nohria, Tarun Khanna and Krishna Palepu at HBS, Dipak Jain and Mohanbir Sawhney at Northwestern's Kellogg School, Jagdish Bhagwati at Columbia and Raj Reddy at Carnegie Mellon.

The list of luminaries is only expected to get longer as the enrolment of Indians in MBA programmes rises. "At the top 20 business schools in the US, one in every four or five is an Indian," says Mohanbir Sawhney. At Kellogg where he teaches, 15%

of the faculty is Indian including the dean. But is it just about the numbers — one billion people so at least 20% have to be smart? "Of course, we're talking about a huge population but it's also about how driven we are to succeed and the value that Indians put on education. There is no safety net; all you have is your degree," says Sawhney, who is often described as the John Maynard Keynes of the Internet age. In an interview to journal Across The Board, Vijay Govindarajan offered this explanation: "Indians have a strong work ethic, speak English and are good at conceptual thinking and analysis." VG, who went to HBS on a Ford Foundation scholarship, is now one of the highest-paid executive coaches in the US. Be it boardroom or MBA programmes, Indians are also bringing in a new perspective on globalisation. "Most of us have been in the US for some time but what was till now not used was our knowledge of India. The unique challenges that emerging markets pose has changed all this," says Sawhney.

With their strong sense of societal obligation, Indians are also tackling issues neglected by Western thinkers. Take C K Prahalad's best-selling book The Fortune at the Bottom of the Pyramid, which stresses the need to take account of micro-markets among the world's poor. Marketing guru Kash Rangan's current research is focused on what marketing can do for the world's poor. 'Solving problems which matter for people who matter' is how Sawhney sums up his philosophy. Are we looking at an Indian ethos of management? "Yes, and it's rooted in spiritual wisdom. Not the dog-eat-dog management philosophy that's been popular till now but something more in sync with businesses of the future," says Sawhney, who often narrates tales from the Panchatantra and Bhagwad Gita to his students at Kellogg. So will there be a change in the way tomorrow's corporations are run? Perhaps, the wind blowing from the Indian subcontinent will tell.

Adapted, based and taken from 'MANAGEMENT GURU? THINK INDIAN NOW by NEELAM RAAJ published in http/www.economictimes.indiatimes.com datelined Sunday, August 27, 2006

Key Terms

Functional Foremanship | Standardisation of Work

Time Study | Motion Study | Fatigue Study | Method Study

Differential Piece Wage System | Mental Revolution

Unity of Command | Unity of Direction

Scalar Chain Gang Plank | Espirit De Corps

Summary

Meaning

Principles of management are general guidelines, which can be used for conduct in work places under certain situations. They help managers to take and implement decisions.

Nature

The nature of management principles can be discussed under the heads- formed by practice; general guidelines; universal; flexible; behavioural; contingent; and cause and effect relationship

Significance

Proper understanding of significance of management principles is essential to make sound decisions by managers. The significance can be discussed under the following heads- Increase in efficiency; Optimum utilisation of resources; Scientific decision making; Adaptation to changing environment; Fulfilling social responsibilities; Proper research and development; Training managers; and Effective administration.

Scientific Management

Taylor's principles of scientific management are — Science, not the rule of thumb; Harmony not discord; Cooperation not individualism; Maximum not restricted output; Development of each person to her/ his greatest efficiency and prosperity. The techniques of scientific management as per Taylor were — Functional foremanship; Standardisation and simplification of work; Fatigue Study; Method Study; Time Study; Motion Study; and Differential Wage System. We can also point out differences between the contributions of Taylor and Fayol but essentially they were complementary in nature.

Fayol's Principles of Management

According to Fayol, the functions of management are to plan, to organise, to command, to coordinate and to control. The activities of an industrial undertaking could be divided into; Technical; Commercial; Financial; Security; Accounting and Managerial. He also suggested that managers should have the following qualities- Physical; Moral; Education; Knowledge; and Experience. Fayol listed 14 principles of management — Division of work; Authority and responsibility; Discipline; Unity of command; Unity of direction; Subordination of individual interest to general interest; Remuneration of Personnel; Centralisation and decentralisation; Scalar Chain; Order; Equity; Stability in the tenure of Personnel; Initiative; and Espirit De corps.

We can also point out differences between the contributions of Taylor and Fayol but essentially they were complementary in nature.

2015-16(21/01/2015)

Exercises

Multiple Choice

1. Principles of management are NOT
   (a) Universal
   (b) Flexible
   (c) Absolute
   (d) Behavioural
2. How are principles of management formed?
   (a) In a laboratory
   (b) By experiences of managers
   (c) By experiences of customers
   (d) By propagation of social scientists
3. The principles of management are significant because of
   (a) Increase in efficiency
   (b) Initiative
   (c) Optimum utilisation of resources
   (d) Adaptation to changing technology
4. Henri Fayol was a
   (a) Social Scientist
   (b) Mining Engineer
   (c) Accountant
   (d) Production engineer
5. Which of the following statement best describes the principle of 'Division of Work'
   (a) Work should be divided into small tasks
   (b) Labour should be divided
   (c) Resources should be divided among jobs
   (d) It leads to specialisation
6. 'She/he keeps machines, materials, tools etc., ready for operations by concerned workers'. Whose work is described by this sentence under functional foremanship
   (a) Instruction Card Clerk
   (b) Repair Boss
   (c) Gang Boss
   (d) Route Clerk
7. Which of the following is NOT a Principle of management given by Taylor ?
   (a) Science, not rule of the Thumb
   (b) Functional foremanship
   (c) Maximum not restricted output
   (d) Harmony not discord

8. Management should find 'One best way' to perform a task. Which technique of Scientific management is defined in this sentence?
   (a) Time Study (b) Motion Study
   (c) Fatigue Study (d) Method Study
9. Which of the following statements best describes 'Mental Revolution'?
   (a) It implies change of attitude.
   (b) The management and workers should not play the game of one upmanship.
   (c) Both management and workers require each other.
   (d) Workers should be paid more wages.
10. Which of the following statements is FALSE about Taylor and Fayol?
   (a) Fayol was a mining engineer whereas Taylor was a mechanical engineer
   (b) Fayol's principles are applicable in specialised situations whereas Taylor's principles have universal application
   (c) Fayol's principles were formed through personal experience whereas Taylor's principles were formed through experimentation
   (d) Fayol's principles are applicable at the top level of management whereas Taylor's principles are applicable at the shop floor.

Short Answer Type

1. How is the Principle of 'Unity of Command' useful to management? Explain briefly.
2. Define scientific management. State any three of its principles.
3. If an organisation does not provide the right place for physical and human resources in an organisation, which principle is violated? What are the consequences of it?
4. Explain any four points regarding significance of Principles of management.
5. Explain the principle of 'Scalar Chain' and gang plank.

Long Answer Type

1. Explain the Principles of Scientific management given by Taylor.
2. Explain the following Principles of management given by Fayol with examples:
   (a) Unity of direction

(b) Equity
(c) Espirit de corps
(d) Order
(e) Centralisation and decentralisation
(f) Initiative

3. Explain the technique of 'Functional Foremanship' and the concept of 'Mental Revolution' as enunciated by Taylor.
4. Discuss the following techniques of Scientific Work Study:
   (a) Time Study
   (b) Motion Study
   (c) Fatigue Study
   (d) Method Study
   (e) Simplification and standardisation of work
5. Discuss the differences between the contributions of Taylor and Fayol.
6. Discuss the relevance of Taylor and Fayol's contribution in the contemporary business environment.

Project Work

1. From business magazines, annual reports, newspapers or internet find out what changes are taking place in companies relating to corporate governance, production practices etc. Prepare a scrapbook. Discuss these cases with your teacher and friends. Prepare a report of the same.
2. Visit a factory. Find about their production system and method of wage payment. Prepare a report and discuss it in your class and with your teacher.

Case Problems

Problem 1

'F' limited was engaged in the business of food processing and selling its products under a popular brand. Lately the business was expanding due to good quality and reasonable prices. Also with more people working the market for processed food was increasing. New players were also coming to cash in on the new trend. In order to keep its market share in the short run the company directed its existing workforce to work overtime.

But this resulted in many problems. Due to increased pressure of work the efficiency of the workers declined. Sometimes the subordinates had to work for more than one superior resulting in declining efficiency. The divisions that were previously working on one product were also made to work on two or more products. This resulted in a lot of overlapping and wasteage. The workers were becoming undisciplined. The spirit of teamwork, which had characterised the company, previously was beginning to wane. Workers were feeling cheated and initiative was declining. The quality of the products was beginning to decline and market share was on the verge of decrease.

Actually the company had implemented changes without creating the required infrastructure.

Questions

1. Identify the Principles of Management (out of 14 given by Henry Fayol) that were being violated by the company.
2. Explain these principles in brief.
3. What steps should the company management take in relation to the above principles to restore the company to its past glory?

Problem 2 (Related to case problem –1)

The management of company 'F' Limited now realised its folly. In order to rectify the situation it appointed a management consultant 'M' consultants to recommend a restructure plan to bring the company back on the rails. 'M' consultants undertook a study of the production process at the plant of the company 'F' limited and recommended the following changes —

1. The company should introduce scientific management with regard to production.
2. Production Planning including routing, scheduling, dispatching and feedback should be implemented.
3. In order to separate planning from operational management 'Functional foremanship' should be introduced.
4. 'Work study' should be undertaken to optimise the use of resources.
5. 'Standardisation' of all activities should be implemented to increase efficiency and accountability.
6. To motivate the workers 'Differential Piece Rate System' should be implemented.

7. The above changes should be introduced apart from the steps recommended in case problem-1 (as an answer to question no 3 of that case problem).

It was expected that the changes will bring about a radical transformation in the working of the company and it will regain its pristine glory.

Questions

1. Do you think that introduction of scientific management as recommended by M consultants will result in intended outcome?
2. What precautions should the company undertake to implement the changes?

   Give your answer with regard to each technique separately as enunciated in points 1 through 6 in the case problem.

BUSINESS ENVIRONMENT

3

CHAPTER

The soft-drinks giants, Pepsico and Coca-Cola, suffered a decline in sales of colas in India in the beginning of the year 2006 after an environmental group, Centre for Science and Environment (CSE) claimed to have found pesticides in their drinks upto 50 times the permissible health limits. These companies issued a number of press statements and conducted many publicity compaigns in India claiming that their beverages were perfectly safe. The Union Health Ministry's expert committee also observes that Coke and Pepsi were safe. CSE, in turn, criticised the expert committees findings and said that 11 of Coke and Pepsi drinks contained average pesticide levels that were 24 times higher than the limits agreed by the Indian government. Despite health ministry's clean chit to colas, several States continue to ban or restrict Coke and Pepsi. However, the pesticide controversy adversely affected the sales of both Coke and Pespi as consumers started watching their diet more closely. Organic food products suddenly became popular as the healthier option. By definition, organic means fruits, vegetables, foodgrains and processed products that have been produced with no pesticide or inorganic fertilisers. Meanwhile the soft drinks giants have been continuously advertising and trying to convince the consumers about the safety of their products.

LEARNING OBJECTIVES

After studying this chapter you will be able to:

- Explain the meaning of business environment;
- Discuss the importance of business environment;
- Describe the various elements of business environment; and
- Examine the economic environment in India and the impact of Government policies on business and industry.

The Pepsi Cola controversy raises an interesting question: Why are soft drinks giants, Coca-Cola and Pepsico putting in so much effort on publicity campaigns in India after the decline in their sales? The answer lies in the fact that their success is dependent not merely on their internal management, but also on many external forces as, for example, decisions and actions of governments, consumers, other business firms and even non-government organisations (NGOs) like CSE. In this chapter, we shall identify certain important external forces (or environmental conditions) and their impact on the operations of business enterprises.

Meaning of Business Environment

The term 'business environment' means the sum total of all individuals, institutions and other forces that are outside the control of a business enterprise but that may affect its performance. As one writer has put it– "Just take the universe, subtract from it the subset that represents the organisation, and the remainder is environment". Thus, the economic, social, political, technological and other forces which operate outside a business enterprise are part of its environment. So also, the individual consumers or competing enterprises as well as the governments, consumer groups, competitors, courts, media and other institutions working outside an enterprise constitute its environment. The important point is that these individuals, institutions and forces are likely to influence the performance of a business enterprise although they happen to exist outside its boundaries. For example, changes in government's economic policies, rapid technological developments, political uncertainty, changes in fashions and tastes of consumers and increased competition in the market — all influence the working of a business enterprise in important ways. Increase in taxes by government can make things expensive to buy. Technological improvements may render existing products obsolete. Political uncertainty may create fear in the minds of investors. Changes in fashions and tastes of consumers may shift demand in the market from existing products to new ones. Increased competition in the market may reduce profit margins of firms.

On the basis of the foregoing discussion, it can be said business environment, has the following features:

(i) **Totality of external forces:** Business environment is the sum total of all things external to business firms and, as such, is aggregative in nature.

(ii) **Specific and general forces:** Business environment includes both specific and general forces. Specific forces (such as investors, customers, competitors and suppliers) affect individual enterprises directly and immediately in their day-to-day working. General forces (such as social, political, legal and technological conditions) have impact on all business enterprises and thus may affect an individual firm only indirectly.

(iii) **Inter-relatedness:** Different elements or parts of business environment are closely interrelated. For example, increased life expectancy of people and increased awareness for health care have increased the demand for many health products and services like diet Coke, fat-free cooking oil, and health resorts. New health products and services have, in turn, changed people's life styles.

(iv) **Dynamic nature:** Business environment is dynamic in that it keeps on changing whether in terms of technological improvement, shifts in consumer preferences or entry of new competition in the market.

(v) **Uncertainty:** Business environment is largely uncertain as it is very difficult to predict future happenings, especially when environment changes are taking place too frequently as in the case of information technology or fashion industries.

(vi) **Complexity:** Since business environment consists of numerous interrelated and dynamic conditions or forces which arise from different sources, it becomes difficult to comprehend at once what exactly constitutes a given environment. In other words, environment is a complex phenomenon that is relatively easier to understand in parts but difficult to grasp in its totality. For example, it may be difficult to know the extent of the relative impact of the social, economic, political, technological or legal factors on change in demand of a product in the market.

(vii) **Relativity:** Business environment is a relative concept since it differs from country to country and even region to region. Political conditions in the USA, for instance, differ from those in China or Pakistan. Similarly, demand for sarees may be fairly high in India whereas it may be almost non-existent in France.

Importance of Business Environment

Just like human beings, business enterprises do not exist in isolation. Each business firm is not an island unto itself; it exists, survives and grows within the context of the element and forces of its environment. While an individual firm is able to do little to change or control these forces, it has no alternative to responding or adapting according to them. A good understanding of environment by business managers enables them not only to identify and evaluate, but also to react to the forces external to their firms. The importance of business environment and its understanding by managers can be appreciated if we consider the following facts:

(i) **It enables the firm to identify opportunities and getting the first mover advantage:** Opportunities refer to the positive external trends or changes that will help a firm to improve its performance. Environment provides numerous opportunities for business success. Early identification of opportunities helps an enterprise to be the first to exploit them instead of losing them to competitors. For example, Maruti Udyog became the leader in the small car market because it was the first to recognise the need for small cars in an environment of rising petroleum prices and a large middle class population in India.

(ii) **It helps the firm to identify threats and early warning signals:** Threats refer to the external environment trends and changes that will hinder a firm's performance. Besides opportunities, environment happens to be the source of many threats. Environmental awareness can help managers to identify various threats on time and serve as an early warning signal. For example, if an Indian firm finds that a foreign multinational is entering the Indian market with new substitutes, it should act as a warning signal. On the basis of this information, the Indian firms can prepare themselves to meet the threat by adopting such measures as improving the quality of the product, reducing cost of the production, engaging in aggressive advertising, and so on.

(iii) **It helps in tapping useful resources:** Environment is a source of various resources for running a business. To engage in any type of activity, a business enterprise assembles various resources called inputs like finance, machines, raw materials, power and water, labour, etc., from its environment including financiers, government and suppliers. They decide to provide these resources with their own expectations to get something in return from the enterprise. The business enterprise supplies the environment with its outputs such as goods and services for customers, payment of taxes to government, return on financial investment to investors and so on. Because the enterprise depends on the environment as a source of inputs or resources and as an outlet for outputs, it only makes sense that the enterprise designs policies that allow it to get the resources that it needs so that it can convert those resources into outputs that the environment desires. This can be done better by understanding what the environment has to offer.

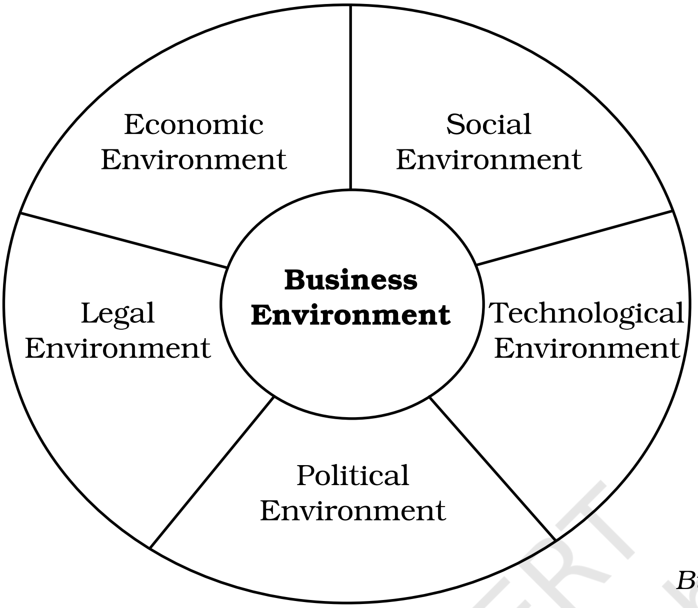
(iv) **It helps in coping with rapid changes:** Today's business environment is getting increasingly dynamic where changes are taking place at a fast pace. It is not the fact of change itself that is so important as the pace of change. Turbulent market conditions, less brand loyalty, divisions and sub-divisions (fragmentation) of markets, more demanding customers, rapid changes in technology and intense global competition are just a few of the images used to describe today's business environment. All sizes and all types of enterprises are facing increasingly dynamic environment. In order to effectively cope with these significant changes, managers must understand and examine the environment and develop suitable courses of action.

(v) **It helps in assisting in planning and policy formulation:** Since environment is a source of both opportunities and threats for a business enterprise, its understanding and analysis can be the basis for deciding the future course of action (planning) or training guidelines for decision making (policy). For instance, entry of new players in the market, which means more competition may make an enterprise think afresh about how to deal with the situation.

(vi) **It helps in improving performance:** The final reason for understanding business environment relates to whether or not it really makes a difference in the performance of an enterprise. The answer is that it does appear to make a difference. Many studies reveal that the future of an enterprise is closely bound up with what is happening in the environment. And, the enterprises that continuously monitor their environment and adopt suitable business practices are the ones which not only improve their present performance but also continue to succeed in the market for a longer period.

Dimensions of Business Environment

Dimensions of, or the factors constituting the business environment include economic, social, technological, political and legal conditions which are considered relevant for decision-making and improving the performance of an enterprise. In contrast to the specific environment, these factors explain the general environment which mostly influences many enterprises at the same time. However, management of every enterprise can benefit from being aware of these dimensions instead of being disinterested in them. For instance, scientific research has



Elements of Business Environment

discovered a technology that makes it possible to produce an energy efficient light bulb that lasts at least twenty times as long as a standard bulb. Senior managers in the lighting divisions at General Electric and Phillips recognised that this discovery had the potential to significantly affect their unit growth and profitability, So they have carefully followed the progress on this research and profitably used its findings. A brief

Components of Economic Environment

- Existing structure of the economy in terms of relative role of private and public sectors.
- The rates of growth of GNP and per capita income at current and constant prices
- Rates of saving and investment
- Volume of imports and exports of different items
- Balance of payments and changes in foreign exchange reserves
- Agricultural and industrial production trends
- Expansion of transportation and communication facilities
- Money supply in the economy
- Public debt (internal and external)
- Planned outlay in private and public sectors

discussion of the various factors constituting the general environment of business is given below:

(i) **Economic Environment:** Interest rates, inflation rates, changes in disposable income of people, stock market indices and the value of rupee are some of the economic factors that can affect management practices in a business enterprise. Short and long term interest rates significantly affect the demand for product and services. For example, in case of construction companies and automobile manufacturers, low longer-term rates are beneficial because they result in increased spending by consumers for buying homes and cars on borrowed money. Similarly, a rise in the disposable income of people due to increase in the gross domestic product of a country creates increasing demand for products. High inflation rates generally result in constraints on business enterprises as they increase the various costs of business such as the purchase of raw materials or machinery and payment of wages and salaries to employees.

Activity I

ECONOMIC ENVIRONMENT

Read the newspapers of the past fifteen days and note the changes in any five economic policies made by the government. Analyse their impact on the working of business enterprises.

RBI is a key regulator of the country's economic environment since it:

- Influences the interest rates
- Controls the flow of money in the economy
- Regulates the working of banks

Salient Features of New Trade Policy (I)

(An Extract)

- Abolition of Service Tax on all exports of goods and services
- Simplification of export procedures
- Establishment of Bio-Technology Parks and Special Economic Zones for handicrafts
- Establishment of Fresh Trade and Warehousing Zones
- Doing away with requirement of Bank Guarantee in case of exporters with turnover of above Rs. 5 Crores.

Based on newspaper reports of August 31st, 05

(ii) **Social Environment:** The social environment of business include the social forces like customs and traditions, values, social trends, society's expectations from business, etc. Traditions define social practices that have lasted for decades or even centuries. For example, the celebration of Diwali, Id, Christmas, and Guru Parv in India provides significant financial opportunities for greetings card companies, sweets or confectionery manufacturers, tailoring outlets and many other related business. Values refer to concepts that a society holds in high esteem. In India, individual freedom, social justice, equality of opportunity and national integration are examples of major values cherished by all of us. In business terms, these values translate into freedom of choice in the market, business's responsibility towards the society and non-discriminatory employment practices. Social trends present various opportunities and threats to business enterprises. For example, the health-and-fitness trend has become popular among large number of urban dwellers. This has created a demand for products like organic food, diet soft drinks, gyms, bottled (mineral) water and food supplements. This trend has, however, harmed business in other industries like dairy processing, tobacco and liquor.

(iii) **Technological Environment:** Technological environment includes forces relating to scientific improvements and innovations which provide new ways of producing goods and services and new methods and techniques of operating a business. For example, recent technological, advances in computers and electronics have modified the ways in

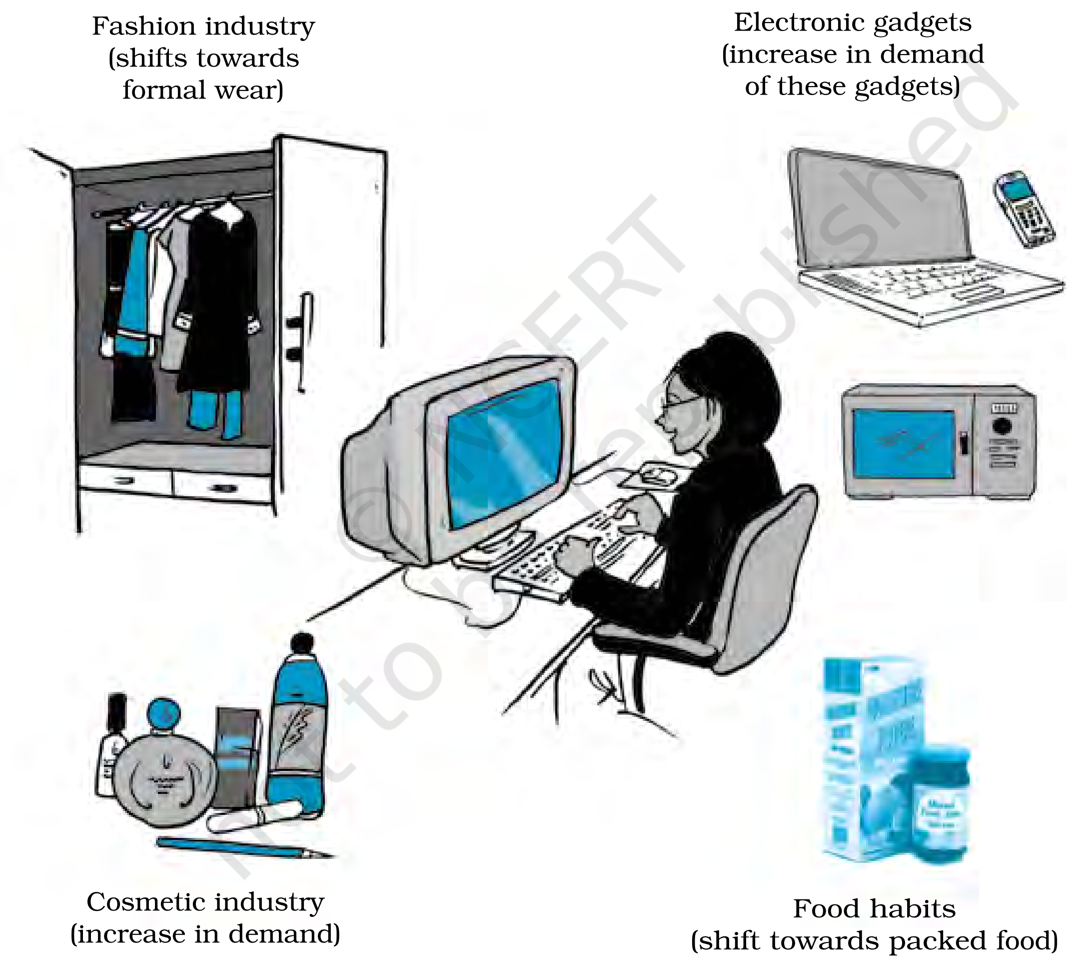
Major Elements of Social Environment

- Attitudes towards product innovations, lifestyles, occupational distribution and consumer preferences
- Concern with quality of life
- Life expectancy
- Expectations from the workforce
- Shifts in the presence of women in the workforce
- Birth and death rates
- Population shifts
- Educational system and literacy rates
- Consumption habits
- Composition of family

Activity II

SOCIAL ENVIRONMENT

Contact any ten families known to you. Find out the changes in their consumption habits over the last five years. Analyse the impact of these changes on the working of business enterprises.



Impact of shifts with the presence of women in the workforce

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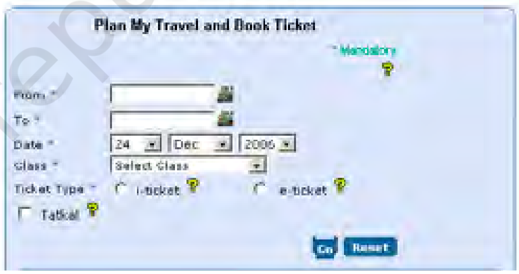

List of Trains

Please Select The Train From The List

S#	Select	Train No	Train Name	Departure	Arrival	Runs on
1	○	2616	G T EXPRESS	18:40	06:15	M T W TH F S SU
2	○	2622	TAMIL NADU EXP	22:30	07:10	M T W TH F S SU
3	○	2652	T N SMPRK KRNTI	07:30	18:10	- T - TH - - -

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Because of technological advancement, it has become possible to book railway tickets through Internet from home, office etc..

which companies advertise their products. It is common now to see CD-ROM's, computerised information kiosks, and Internet/ World Wide Web multimedia pages highlighting the virtues of products. Similarly, retailers have direct links with suppliers who replenish stocks when needed. Manufacturers have flexible manufacturing systems. Airline companies have Internet and World Wide Web pages where customers can look for flight times, destinations and fares and book their tickets online. In addition, continuing innovations in different scientific and engineering fields such as lasers, robotics, biotechnology, food preservatives, medicine, telecommunication and synthetic fuels have provided numerous opportunities and threats for many different enterprises. Shifts in demand from vaccum tubes to transistors, from steam locomotives to dieseland electric engines, from fountain pens to ballpoint, from propeller airplanes to jets, and from typewriters to computer based word processors, have all been responsible and creating new business.

(iv) **Political Environment:** Political environment includes political conditions such as general stability and peace in the country and specific attitudes that elected government representatives hold towards business. The significance of political conditions in business success lies in the predictability of business activities under stable political conditions. On the other hand, there may be uncertainty of business activities due to political unrest and threats to law and order. Political stability,

Major Elements of Political Environment

- The Constitution of the country
- Prevailing political system
- The degree of politicisation of business and economic issues
- Dominant ideologies and values of major political parties
- The nature and profile of political leadership and thinking of political personalities
- The level of political morality
- Political institutions like the government and allied agencies
- Political ideology and practices of the ruling party
- The extent and nature of government intervention in business
- The nature of relationship of our country with foreign countries

thus, builds up confidence among business people to invest in the long term projects for the growth of the economy. Political instability can shake that confidence. Similarly, the attitudes of government officials towards business may have either positive or negative impact upon business. For example, even after opening up of our economy in 1991, foreign companies found it extremely difficult to cut through the bureaucratic red tape to get permits for doing business in India. Sometimes, it took months to process even their application for the purpose. As a result these companies were discouraged from investing in our country. The situation has improved over time.

(v) **Legal Environment:** Legal environment includes various legislations passed by the Government administrative orders issued by government authorities, court judgments as well as the decisions rendered by various commissions and agencies at every level of the government— centre, state or local. It is imperative for the management of every enterprise to obey the law of the land. Therefore, an adequate knowledge of rules and regulations framed by the Government is a pre-requisite for better business performance. Non-compliance of laws can land the business enterprise into legal problems. In India, a working knowledge of Companies Act 1956; Industries (Development and Regulations) Act 1951; Foreign Exchange Management Act and the Imports and Exports (Control) Act 1947; Factories Act, 1948; Trade Union Act; 1926; Workmen's Compensation Act, 1923; Industrial Disputes Act, 1947, Consumer Protection Act, 1986, Competition Act, 2002 and host of such other legal enactments as amended from time to time by the Parliament, is important for doing business. Impact of legal environment can be illustrated with the help of government regulations to protect consumer's interests. For example, the advertisement of alcoholic beverages is prohibited. Advertisements, including packets of cigarettes carry the statutory warning 'Cigarette smoking is injurious to health'. Similarly, advertisements of baby food must necessarily inform the potential buyer that mothers milk is the best. All these regulations are required to be followed by advertisers.

Economic Environment in India

The economic environment in India consists of various macro-level factors related to the means of production and distribution of wealth which have an impact on business and industry. These include:

(a) Stage of economic development of the country.
(b) The economic structure in the form of mixed economy which recognises the role of both public and private sectors.
(c) Economic policies of the Government, including industrial, monetary and fiscal policies.
(d) Economic planning, including five year plans, annual budgets, and so on.
(e) Economic indices, like national income, distribution of income, rate and growth of GNP, per capita income, disposal personal income, rate of savings and investments, value of exports and imports, balance of payments, and so on.
(f) Infrastructural factors, such as, financial institutions, banks, modes of transportation communication facilities, and so on.

Business enterprises in India do realise the importance and impact of the economic environment on their working. Almost all annual company reports presented by their chairpersons devote considerable attention to the general economic environment prevailing in the country and an assessment of its impact on their companies.

The economic environment of business in India has been steadily changing mainly due to the government policies. At the time of Independence:

(a) The Indian economy was mainly agricultural and rural in character;
(b) About 70% of the working population was employed in agriculture;
(c) About 85% of the population was living in the villages;
(d) Production was carried out using irrational, low productivity technology;
(e) Communicable diseases were widespread, mortality rates were high. These was no good public health system.

In order to solve economic problems of our country, the government took several steps including control by the State of certain industries, central planning and reduced importance of the private sector. The main objectives of India's development plans were:

(a) Initiate rapid economic growth to raise the standard of living, reduce unemployment and poverty;
(b) Become self-reliant and set up a strong industrial base with emphasis on heavy and basic industries;
(c) Reduce inequalities of income and wealth;
(d) Adopt a socialist pattern of development — based on equality and prevent exploitation of man by man.

In accordance with the economic planning, the government gave a lead role to the public sector for

Crisis of June 1991

Major elements of the crisis situation which led the Government of India to announce economic reform were:

- A serious fiscal crisis in which the fiscal deficit reached the level of 6.6 per cent of GDP in 1990-91.
- Heavy internal debt which rose to about 50 per cent of GDP with interest payments draining about 39 per cent of total revenue collections of the central government.
- Low GNP growth rate which fell to 1.4 per cent from the peak level of 10.5 per cent in 1988-89 (at 1980-81 prices).
- Low overall agricultural production, foodgrain production and industrial production showed negative growth rates of –2.8 per cent, –5.3 per cent and –0.1 per cent respectively.
- Soaring inflation rate based both on wholesale price index and consumer price index (for industrial workers) at 13-14 per cent.
- Shrinkage of foreign trade, imports (in $ terms) fell by 19.4 per cent and exports by 1.5 per cent.
- Depreciation of rupee by 26.7 per cent vis-à-vis US dollars.
- Fall of foreign exchange reserves to such a low level that they were barely adequate to meet the import requirements of a few weeks. Non-resident Indians (NRIs) were withdrawing their deposits at an alarmingly high rate.
- The confidence of the international financial institutions was badly shaken and in just over a year its creditworthiness rating fell from AAA to BB+ (put on credit watch).
- The country was on the verge of defaulting on international financial obligations and the situation warranted immediate policy action to save the situation. In May 1991, the Government had to lease 20 tones of gold out of its stock to the State Bank of India to enable it to sell the gold with repurchase option after six months. In addition, Reserve Bank of India was allowed to pledge 47 tones of gold to the Bank of England to raise a loan of $600 million.

infrastructure industries whereas the private sector was broadly given the responsibility of developing consumer goods industry. At the same time, the government imposed several restrictions, regulations and controls on the working of private sector enterprises. India's experience with economic planning has delivered mixed results. In 1991 the economy faced a serious foreign exchange crisis, high government deficit and a rising trend of prices despite bumper crops.

As a part of economic reforms, the Government of India announced a new industrial policy in July 1991.

The broad features of this policy were as follows:

(a) The Government reduced the number of industries under compulsory licensing to six.
(b) Many of the industries reserved for the public sector under the earlier policy, were dereserved. The role of the public sector was limited only to four industries of strategic importance.
(c) Disinvestment was carried out in case of many public sector industrial enterprises.
(d) Policy towards foreign capital was liberalised. The share of foreign equity participation was increased and in many activities 100 per cent Foreign Direct Investment (FDI) was permitted.
(e) Automatic permission was now granted for technology agreements with foreign companies.
(f) Foreign Investment Promotion Board (FIPB) was set up to promote and channelise foreign investment in India.

Appropriate measures were taken to remove obstacles in the way of growth and expansion of industrial units of large industrial houses. Small-scale sector was assured all help and accorded due recognition.

In essence, this policy has sought to liberate industry from the shackles of the licensing system (liberalisation), drastically reduce the role of the public sector (privatisation) and encourage foreign private participation in India's industrial development (globalisation).

Liberalisation: The economic reforms that were introduced were aimed at liberalising the Indian business and industry from all unnecessary controls and restrictions. They signalled the end of the licence-pemit-quota raj. Liberalisation of the Indian industry has taken place with respect to:

(i) abolishing licensing requirement in most of the industries except a short list,
(ii) freedom in deciding the scale of business activities i.e., no restrictions on expansion or contraction of business activities,
(iii) removal of restrictions on the movement of goods and services,
(iv) freedom in fixing the prices of goods services,
(v) reduction in tax rates and lifting of unnecessary controls over the economy,
(vi) simplifying procedures for imports and experts, and
(vii) making it easier to attract foreign capital and technology to India.

Privatisation: The new set of economic reforms aimed at giving greater role to the private sector in the nation building process and a reduced role to the public sector. This was a reversal

Early Crisis Met : Reform Measures

Some of the early major steps taken to manage the economic crisis were the following:

- Fiscal correction aimed at reducing fiscal deficit by about Rs. 7,700 crore in 1991-92 (compared to 1990-91);
- Announcement of New Industry Policy in July 1991 seeking to deregulate the industry with the objective of promoting the growth of a more competitive and efficient industrial economy;
- Abolition of industrial licensing for all industrial projects except 18 industries of high strategic and environmental importance and with high import content. About 80 per cent of the industries were delicensed;
- Amendment of the MRTP Act to eliminate the need for prior approval of the Central Government by large companies for capacity expansion, diversification and merger and amalgamation.
- Nine areas in basic and core industries earlier reserved for the public sector were opened to the private sector;
- Limit of foreign equity holding raised from 40 per cent to 51 per cent in a wide range of priority industries;
- Foreign Investment Promotion Board (FIPB) established to negotiate proposals from large international firms and expedite clearances of the investment proposals;
- Rupee devaluation by 18 per cent during July 1-3, 1991 supported by a standby credit of $2.3 billion from the IMP over a 20 months period negotiated in October 1991;
- Negotiation of $500 million Structural Adjustment Loan from the World Bank in April 1992 and a loan totalling SDR 1.3 billion from the International Monetory Fund (IMF) between January-September 1991;
- Introduction of India Development Bond Scheme and Immunity Scheme for repatriation of funds held abroad in October 1991, under which more than $2 billion were mobilised during 1991-92;
- Bringing back of gold earlier pledged to the Bank of England and the Bank of Japan;
- Continuance of the measures of import control and credit squeeze;
- Administered licensing of imports replaced by freely tradeable import entitlements (called Eximscrips) linked to export earnings. The measure was expected to introduce self-balancing mechanism in India's foreign trade;
- Introduction of Liberalised Exchange Rate Management System (LERMS) under which a dual exchange rate system was established, one rate being effectively floated in the market; and
- Import licensing in most capital goods, raw materials, intermediates and components eliminated. Advance Licensing System considerably simplified.

The initial series of measures set the tone for the future economic reforms. Any of the measures taken above was continued to form a part of the ongoing reform process.

of the development strategy pursued so far by Indian planners. To achieve this, the government redefined the role of the public sector in the New Industrial Policy of 1991, adopted the policy of planned disinvestments of the public sector and decided to refer the loss making and sick enterprises to the Board of Industrial and Financial Reconstruction. The term disinvestments used here means transfer in the public sector enterprises to the private sector. It results in dilution of stake of the Government in the public enterprise. If there is dilution of Government ownership beyond 51 percent, it would result in transfer of ownership and management of the enterprise to the private sector.

Globalisation: Globalisation means the integration of the various economies of the world leading towards the emergence of a cohesive global economy. Till 1991, the Government of India had followed a policy of strictly regulating imports in value and volume terms. These regulations were with respect to (a) licensing of imports, (b) tariff restrictions and (c) quantitative restrictions. The new economic reforms aimed at trade liberalisation were directed towards import liberalisation, export promotion through rationalisation of the tariff structure and reforms with respect to foreign exchange so that the country does not remain isolated from the rest of the world. Globalisation involves an increased level of interaction and interdependence among the various nations of the global economy. Physical geographical gap or political

A Truly Globalised Economy

A truly global economy implies a boundaryless world where there is:

(i) Free flow of goods and services across nations;
(ii) Free flow of capital across nations;
(iii) Free flow of information and technology;
(iv) Free movement of people across borders;
(v) A common acceptable mechanism for the settlement of disputes;
(vi) A global governance perspective.

Activity 3

GLOBALISATION

Make a list of five Indian companies which have global operations today. Find out the major products they sell and the countries where they operate.

boundaries no longer remain barriers for a business enterprise to serve a customer in a distant geographical market. This has been made possible by the rapid advancement in technology and liberal trade policies by Governments. Through the policy of 1991, the government of India moved the country to this globalisation pattern.

Impact of Government Policy Changes on Business and Industry

The policy of liberalisation, privatisation and globalisation of the Government has made a significant impact on the working of enterprises in business and industry. The Indian corporate sector has come face-to-face with several challenges due to government policy changes. These challenges can be explained as follows:

(i) **Increasing competition:** As a result of changes in the rules of industrial licensing and entry of foreign firms, competition for Indian firms has increased especially in service industries like telecommunications, airlines, banking, insurance, etc. which were earlier in the public sector.

(ii) **More demanding customers:** Customers today have become more demanding because they are well-informed. Increased competition in the market gives the customers wider choice in purchasing better quality of goods and services.

(iii) **Rapidly changing technological environment:** Increased competition forces the firms to develop new ways to survive and grow in the market. New technologies make it possible to improve machines, process, products and services. The rapidly changing technological environment creates tough challenges before smaller firms.

(iv) **Necessity for change:** In a regulated environment of pre-1991 era, the firms could have relatively stable policies and practices. After 1991, the market forces have become turbulent as a result of which the enterprises have to continuously modify their operations.

(v) **Need for developing human resource:** Indian enterprises have suffered for long with inadequately trained personnel. The new market conditions require people with higher competence and greater commitment. Hence the need for developing human resources.

(vi) **Market orientation:** Earlier firms used to produce first and go to the market for sale later. In other words, they had production oriented marketing operations. In a fast changing world, there is a shift to market orientation in as much as the firms have to study and analyse the market first and produce goods accordingly.

(vii) **Loss of budgetary support to the public sector:** The central government's budgetary support for financing the public sector outlays has declined over the years. The public sector undertakings have realised that, in order to survive and grow, they will have to be more efficient and generate their own resources for the purpose.

On the whole, the impact of Government policy changes particularly in respect of liberalisation, privatisation and globalisation has been positive as the Indian business and industry has shown great resilience in dealing with the new economic order. Indian enterprises have developed strategies and adopted business processes and procedures to meet the challenge of competition. They have become more customer-focused and adopted measures to improve customer relationship and satisfaction.

Key Terms

Business environment | Opportunities | Threats | Economic Environment | Political environment | Social environment | Technological environment | Legal environment | Liberalisation | Privatisation | Globalisation

Summary

Meaning of business environment: The term business environment means the totality of all individuals, institutions and other forces that are outside a business but that potentially affect its performance. Business environment can be characterised in terms of
(a) totality of external forces
(b) specific and general forces
(c) inter-relatedness
(d) dynamic nature
(e) uncertainty
(f) complexity
(g) relativity

Importance of business environment: Business environment and its understanding are important for (i) enabling the identification of opportunities and getting the first mover advantage, (ii) helping in the identification of threats and early warning signals, (iii) coping with the rapid changes, (v) assisting in planning and policy and (vi) improving the performance.

Elements of business environment: Business environment consists of five important dimensions including economic, social, technological, political and legal.

Economic environment includes such factors as interest rates, inflation rates, changes in disposable income of people, stock market indexes and the value of rupee.

Social environment includes social forces like traditions, values, social trends, society's expectations of business, and so on.

Technological environment includes forces relating to scientific improvements and innovations which provide new ways of producing goods and services and new methods and techniques of operating a business.

Political environment includes political conditions such as general stability and peace in the country and specific attitudes that elected government representatives hold toward business.

Legal environment includes various legislations passed by the government, administrative orders issued by government authorities, court judgments as well as decisions rendered by various commissions and agencies at every level of the government—center, state or local.

Economic environment in India: The economic environment in India consists of various macro-level factors related to the means of production and distribution of wealth which have an impact on business and industry. The economic environment of business in India has been steadily changing since Independence mainly due to government policies. In order to solve economic problems of our country at the time of Independence, the government took several steps including control by the state of key industries, central planning and reduced importance of the private sector. These steps delivered mixed results until 1991 when Indian economy happened to face serious foreign exchange crisis, high government deficit and a rising trend of prices despite bumper crops.

Liberalisation, privatisation and globalisation: As a part of economic reforms, the Government of India announced a new industrial policy in July 1991 which sought to liberate the industry from the shackles of the licensing system (liberalisation), drastically reduce the role of the public sector (privatisation) and encourage foreign private participation in industrial development (globalisation).

Impact of Government policy changes on business and industry: The government policy of liberalisation, privatisation and globalisation has made a definite impact on the working of enterprises in business and industry in terms of

(a) increasing competition
(b) more demanding customers
(c) rapidly changing technological environment
(d) necessity for change
(e) need for developing human resource
(f) market orientation
(g) loss of budgetary support to the public sector. In the new economic environment, the Indian enterprises have developed various strategies to meet the challenge of competition

Exercises

Multiple Choice

1. Which of he following does not characterise the business environment?
   (a) Uncertainty
   (b) Employees
   (c) Relativity
   (d) Complexity
2. Which of the following best indicates the importance of business environment?
   (a) Identification
   (b) Improvement in performance
   (c) Coping with rapid changes
   (d) All of them
3. Which of the following is an example of social environment?
   (a) Money supply in the economy
   (b) Consumer Protection Act
   (c) The Constitution of the country
   (d) Composition of family
4. Liberalisation means
   (a) Integration among economies
   (b) Reduced government controls and restrictions
   (c) Policy of planned disinvestments
   (d) none of them

5. Which of the following does not explain the impact of Government policy changes on business and industry?
   (a) More demanding customers
   (b) Increasing competition
   (c) Change in agricultural prices
   (d) Market orientation

Short Answer Type

1. What do you understand by business environment?
2. Why it is important for business enterprises to understand their environment? Explain briefly.
3. Mention the various dimensions of business environment.
4. Briefly explain the following:
   (a) Liberalisation
   (b) Privatisation
   (c) Globlisation
5. Briefly discuss the impact of Government policy changes on business and industry.

Long Answer Type

1. How would you characterise business environment? Explain, with examples, the difference between general and specific environment.
2. How would you argue that the success of a business enterprise is significantly influenced by its environment?
3. Explain, with examples, the various dimensions of business environment.
4. What economic changes were initiated by the Government under the Industrial Policy, 1991? What impact have these changes made on business and industry?
5. What are the essential features of (a) Liberalisation, (b) Privatisation and (c) Globalisation?

Activities

1. Select a business enterprise with which you are familiar. From your recollection of current events (events you may have read about in newspapers or magazines or have heard about on television or radio) identify some of the important environmental force, which have had impact on this enterprise.

2. Select a major Indian company for which there is considerable information available in your school library. Analyse the impact of changes in the Government policies on the working of this company.

Case Problem

Lately many companies have planned for significant investment in organised retailing in India. Several factors have prompted their decisions in this regard.

Customer income is rising. People have developed a taste for better quality products even though they may have to pay more. The aspiration levels have increased. The government has also liberalised its economic policies in this regard and permitted even cent percent foreign direct investment in some sectors of retailing.

Questions

1. Identify changes in business environment under different heads — economic, social, technological, political and legal that have facilitated the companies' decisions to plan significant investments in organised retailing.
2. What has been the impact of these changes with regard to globalisation and privatisation?

4
CHAPTER

Planning

Gas Authority of India (GAIL) – New Plans

GAIL India, which has had a monopoly in the gas transmission sector is set to see some tough competition in the coming days. While Reliance is poised to get into the trunk pipeline segment, British Gas is trying to get into the city gas distribution sector. GAIL's new chairman, shares his thoughts on how he plans to take the company ahead.

What are GAIL's main priorities?

Going by its business strategy, the focus areas are gas sourcing, transmission, marketing, processing, petrochemicals, globalisation and city gas distribution. We are focussing on sourcing of gas from indigenous finds and through LNG and crossborder pipelines. We intend to develop the gas market by extending our gas grid from 5,600 km to 10,000 km. The city gas project is expected to rise from 6 to 45 by the end of the 11th five year Plan.

What are GAIL's plans for acquiring an exploration and production (E&P) company abroad?

GAIL has plans to strengthen its exploration and production activities. To become a formidable company, GAIL is exploring options - acquiring an E&P company is one such option.

What are your Capex plans and how do you plan to fund it?

GAIL's budgeted Capex plan for FY 06-07 is Rs. 2967.28 crore. This includes capital expenditure of Rs. 2579.58 crore on pipeline and other projects and Rs. 387.7 crore on petrochemical projects. This will be funded through internal reserves.

What are your plans on city gas distribution? Will GAIL continue with its plans on fuel management?

We have already established the business successfully in Mumbai, Delhi, Vadodara, Vijaywada, Agra, Lucknow, Kanpur. Till date GAIL has formed eight joint venture companies to implement city gas projects. The projects have had an impact on the pollution levels. GAIL is in the process of forming state-wise Joint Ventures with oil marketing companies to implement city gas projects in Rajasthan.

What are GAIL's plans to diversify into telecom and what is the current status?

LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- State the meaning of planning;
- Describe the features and importance of planning;
- Explain the limitations of planning;
- Analyse the steps in the planning process; and
- Identity the different types of plans.

Gailtel, the telecom service arm of GAIL, offers telecom services commercially to lead telecom operators across India. Gailtel owns and operates approximately 13,000 route km of fibre optic network, GAIL is evaluating various options to work out its future growth plans.

Source: The Economic Times, October 2006

Introduction

You have just read about the plans of Gas Authority of India Limited (GAIL), It is one of our leading public sector companies. The plans discussed by the Chairperson, GAIL are real plans of the company and how they would like to go about achieving their objectives. Of course, these are broad statements given by the company and they have to be broken down into steps for implementation. This is an example of a company in the public sector with a nation-wide reach striving to be one of the top companies in India. Further more, every organisation whether it is government-owned, a privately owned business or a company in the private sector requires planning. The government makes five year plans for the country, a small business has it's own plans, while other companies have big plans, sales plans, production plans. All of them have some plans.

All business firms would like to be successful, increase their sales and earn profits. All managers dream of these and strive to achieve their goals. But to turn these dreams into reality managers need to work hard in thinking about the future, in making business predictions and achieving targets. Dreams can be turned into reality only if business managers think in advance on what to do and how to do it. This is the essence of planning.

Concept

Planning is deciding in advance what to do and how to do. It is one of the basic managerial functions. Before doing something, the manager must formulate an idea of how to work on a particular task. Thus, planning is closely connected with creativity and innovation. But the manager would first have to set objectives, only then will a manager know where he has to go. Planning seeks to bridge the gap between where we are and where we want to go. Planning is what managers at all levels do. It requires taking decisions since it involves making a choice from alternative courses of action.

Planning, thus, involves setting objectives and developing appropriate courses of action to achieve these objectives. Objectives provide direction for all managerial decisions and actions. Planning provides a rational

Planning: Keeping the objective in view and being in action

approach for achieving predetermined objectives. All members, therefore, need to work towards achieving organisational goals. These goals set the targets which need to be achieved and against which actual performance is measured. Therefore, planning means setting objectives and targets and formulating an action plan to achieve them. It is concerned with both ends and means i.e., what is to be done and how it is to be done.

The plan that is developed has to have a given time frame but time is a limited resource. It needs to be utilised judiciously. If time factor is not taken into consideration, conditions in the environment may change and all business plans may go waste. Planning will be a futile exercise if it is not acted upon or implemented.

Do you think from the above we can formulate a comprehensive definition of planning? One of the ways to do so would be to define planning as setting objectives for a given time period, formulating various courses of action to achieve them, and then selecting the best possible alternative from among the various courses of action available.

Importance of Planning

You must have seen in films and advertisements how executives draw up plans and make powerful presentations in boardrooms. Do those plans actually work? Does it improve efficiency? After all why should we plan? These are numerous questions to which we would like to find solutions. Planning is certainly important as it tells us where to go, it provides direction and reduces the risk of uncertainty by preparing forecasts. The major benefits of planning are given below:

(i) **Planning provides directions:** By stating in advance how work is to be done planning provides direction for action. Planning ensures that the goals or objectives are clearly stated so that they act as a guide for deciding what action should be taken and in which direction. If goals are well defined, employees are aware of what the organisation has to do and what they must do to achieve those goals. Departments and individuals in the organisation are able to work in coordination. If there was no planning, employees would be working in different directions and the organisation would not be able to achieve its desired goals.

(ii) **Planning reduces the risks of uncertainty:** Planning is an activity which enables a manager to look ahead and anticipate changes. By deciding in advance the tasks to be performed, planning shows the way to deal with changes and uncertain events. Changes or events cannot be eliminated but they can be anticipated and managerial responses to them can be developed.

(iii) **Planning reduces overlapping and wasteful activities:** Planning serves as the basis of coordinating the activities and efforts of different divisions, departments and individuals. It helps in avoiding confusion and misunderstanding. Since planning ensures clarity in thought and action, work is carried on smoothly without interruptions. Useless and redundant activities are minimised or eliminated. It is easier to detect inefficiencies and take corrective measures to deal with them.

(iv) **Planning promotes innovative ideas:** Since planning is the first function of management, new ideas can take the shape of concrete plans. It is the most challenging activity for the management as it guides all future actions leading to growth and prosperity of the business.

(v) **Planning facilitates decision making:** Planning helps the manager to look into the future and make a choice from amongst various alternative courses of action. The manager has to evaluate each alternative and select the most viable proposition. Planning involves setting targets and predicting future conditions, thus helping in taking rational decisions.

(vi) **Planning establishes standards for controlling:** Planning involves setting of goals. The entire managerial process is concerned with accomplishing predetermined goals through planning, organising, staffing, directing and controlling. Planning provides the goals or standards against which actual performance is measured. By comparing actual performance with some standard, managers can know whether they have actually been able to attain the goals. If there is any deviation it can be corrected. Therefore, we can say that planning is a prerequisite for controlling. If there were no goals and standards, then finding deviations which are a part of controlling would not be possible. The nature of corrective action required depends upon the extent of deviations from the standard. Therefore, planning provides the basis of control.

Features of Planning

In the example of Polaris, the company has plans of expansion. Their objective is to increase their capacity so that they can employ 800 more professionals. Their target time is six months. The objective of the current year has also been clearly stated which is to increase capacity by 1500-2000 more professionals. Since planning is the primary function of management they have set their objectives first. Thus, all businesses follow a set pattern of planning. You will be able to find some similarities in the features of planning and what you see in real life. Try and identify them.

The planning function of the management has certain special features. These features throw light on its nature and scope.

(i) **Planning focuses on achieving objectives:** Organisations are set up with a general purpose in view. Specific goals are set out in the plans along with the activities to be undertaken to achieve the goals. Thus, planning is purposeful. Planning has no meaning unless it contributes to the achievement of predetermined organisational goals.

(ii) **Planning is a primary function of management:** Planning lays down the base for other functions of management. All other managerial functions are performed within the framework of the plans drawn. Thus, planning precedes other functions. This is also referred to as the primacy of planning. The various functions of management are interrelated and equally important. However, planning provides the basis of all other functions.

(iii) **Planning is pervasive:** Planning is required at all levels of management as well as in all departments of the organisation. It is not an exclusive function of top management nor of any

Polaris Plans New Facility in Mumbai

IT Company Polaris Software Lab is planning a new facility in Mumbai with a capacity for 800 professionals.

The company currently has 1,200 professionals across its three centers in Mumbai, and the new facility is expected to come up in the next six months.

Polaris chairman and CEO said that the company was well on the track to meet its earlier announcement to increase the headcount by 1,500-2,000 professionals in the current year to reach the 9,000 mark by March 2007. We will look at acquisition of small boutique consulting companies that are focused on banking, financial services and insurance (BFSI) space. This will strengthen customer service and account management capabilities.

Source: The Economic Times, October 06 particular department. But the scope of planning differs at different levels and among different departments. For example, the top management undertakes planning for the organisation as a whole. Middle management does the departmental planning. At the lowest level, day-to-day operational planning is done by supervisors.

(iv) **Planning is continuous:** Plans are prepared for a specific period of time, may be for a month, a quarter, or a year. At the end of that period there is need for a new plan to be drawn on the basis of new requirements and future conditions. Hence, planning is a continuous process. Continuity of planning is related with the planning cycle. It means that a plan is framed, it is implemented, and is followed by another plan, and so on.

(v) **Planning is futuristic:** Planning essentially involves looking ahead and preparing for the future. The purpose of planning is to meet future events effectively to the best advantage of an organisation. It implies peeping into the future, analysing it and predicting it. Planning is, therefore, regarded as a forward looking function based on forecasting. Through forecasting, future events and conditions are anticipated and plans are drawn accordingly. Thus, for example, sales forecasting is the basis on which a business firm prepares its annual plan for production and sales.

(vi) **Planning involves decision making:** Planning essentially involves choice from among various alternatives and activities. If there is only one possible goal or a possible course of action, there is no need for planning because there is no choice. The need for planning arises only when alternatives are available. In actual practice, planning presupposes the existence of alternatives. Planning, thus, involves thorough examination and evaluation of each alternative and choosing the most appropriate one.

(vii) **Planning is a mental exercise:** Planning requires application of the mind involving foresight, intelligent imagination and sound

Planning: the first step to management

judgement. It is basically an intellectual activity of thinking rather than doing, because planning determines the action to be taken. However, planning requires logical and systematic thinking rather than guess work or wishful thinking. In other words, thinking for planning must be orderly and based on the analysis of facts and forecasts.

Limitations of Planning

We have seen how planning is essential for business organisations. It is difficult to manage operations without formal planning. It is important for an organisation to move towards achieving goals. But we have often seen in our daily lives also, that things do not always go according to plan. Unforeseen events and changes, rise in costs and prices, environmental changes, government interventions, legal regulations, all affect our business plans. Plans then need to be modified. If we cannot adhere to our plans, then why do we plan at all? This is what we need to analyse. The major limitations of planning are given below:

(i) **Planning leads to rigidity:** In an organisation, a well-defined plan is drawn up with specific goals to be achieved within a specific time frame. These plans then decide the future course of action and managers may not be in a position to change it. This kind of rigidity in plans may create difficulty. Managers need to be given some flexibility to be able to cope with the changed circumstances. Following a pre-decided plan, when circumstances have changed, may not turn out to be in the organisations interest.

International Ambitions of Essar

The Essar group is looking to step up its global operations by entering the riskier but profitable markets of Africa, eastern Europe and the Middle East.

In its core business of steel, the Essar group is also looking at a proposal to acquire an integrated steel plant in Eastern Europe.

The group has also announced its intention of setting up Greenfield steel manufacturing operations in Sharjah, Qatar and Iran. It has plans to set up a 50-50 joint venture with state-owned Qatar Steel Company for a 1.5 million ton steel plant along with a 1 million ton steel rolling plant on the outskirts of Sharjah and another ton per annum steel plant in Iran, according to a recent Essar newsletter. Even the Indonesia branch of Essar, where the group runs a cold-rolling complex, is expected to look for merger and acquisitions (M & A) opportunities in the region.

Source: Business World, 25th September 06

(ii) **Planning may not work in a dynamic environment:** The business environment is dynamic, nothing is constant. The environment consists of a number of dimensions, economic, political, physical, legal and social dimensions. The organisation has to constantly adapt itself to changes. It becomes difficult to accurately assess future trends in the environment if economic policies are modified or political conditions in the country are not stable or there is a natural calamity. Competition in the market can also upset financial plans, sales targets may have to be revised and, accordingly, cash budgets also need to be modified since they are based on sales figures. Planning cannot foresee everything and thus, there may be obstacles to effective planning.

(iii) **Planning reduces creativity:** Planning is an activity which is done by the top management. Usually the rest of the members just implements these plans. As a consequence, middle management and other decision makers are neither allowed to deviate from plans nor are they permitted to act on their own. Thus, much of the initiative or creativity inherent in them also gets lost or reduced. Most of the time, employees do not even attempt to formulate plans. They only carry out orders. Thus, planning in a way reduces creativity since people tend to think along the same lines as others. There is nothing new or innovative.

(iv) **Planning involves huge costs:** When plans are drawn up huge costs are involved in their formulation. These may be in terms of time and money for example, checking accuracy of facts may involve lot of time. Detailed plans require scientific calculations to ascertain facts and figures. The costs incurred sometimes may not justify the benefits derived from the plans. There are a number of incidental costs as well, like expenses on boardroom meetings, discussions with professional experts and preliminary investigations to find out the viability of the plan.

(v) **Planning is a time-consuming process:** Sometimes plans to be drawn up take so much of time that there is not much time left for their implementation.

(vi) **Planning does not guarantee success:** The success of an enterprise is possible only when plans are properly drawn up and implemented. Any plan needs to be translated into action or it becomes meaningless. Managers have a tendency to rely on previously tried and tested successful plans. It is not always true that just because a plan has worked before it will work again. Besides, there are so many other unknown factors to be considered. This kind of complacency and false sense of security may actually lead to failure instead of success. However, despite its limitations, planning is not a useless exercise. It is a tool to be used with caution. It provides a base for analysing future courses of action. But, it is not a solution to all problems.

Planning Process

Planning, as we all know is deciding in advance what to do and how to do. It is a process of decision making. How do we go about making a plan? Since planning is an activity there are certain logical steps for every manager to follow.

(i) **Setting Objectives:** The first and foremost step is setting objectives. Every organisation must have certain objectives. Objectives may be set for the entire organisation and each department or unit within the organisation. Objectives or goals specify what the organisation wants to achieve. It could mean an increase in sales by 20% which could be objective of the entire organisation. How all departments would contribute to the organisational goals is the plan that is to be drawn up. Objectives should be stated clearly for all departments, units and employees. They give direction to all departments. Departments/ units then need to set their own objectives within the broad framework of the organisation's philosophy. Objectives have to percolate down to each unit

Ministry Draws up Plan to Turn Around SEB's by '08

To give a boost to the financial health of state electricity boards (SEBs), the power ministry has outlined an 11-point agenda to initiate their financial turnaround by 2007-08. Suggestions include changes in the way distribution utilities submit tariff-fixation petitions to the regulators and introduction of the concept of a proper time-bound business plan.

The ministry has asked all utilities to adopt a multi-year tariff approach while filing the next tariff petition for 2007-08 before the state regulator. This must be undertaken before December 2006. It has also asked utilities to have a state-approved business plan with identifiable goals for a three, six and 12-month period. Also, approval needs to be sought from the state regulator for automatic tariff adjustment to recover additional fuel and other unanticipated costs.

Source: The Economic Times, September 06 and employees at all levels. At the same time, managers must contribute ideas and participate in the objective setting process. They must also understand how their actions contribute to achieving objectives. If the end result is clear it becomes easier to work towards the goal.

(ii) **Developing Premises:** Planning is concerned with the future which is uncertain and every planner is using conjecture about what might happen in future. Therefore, the manager is required to make certain assumptions about the future. These assumptions are called premises. Assumptions are the base material upon which plans are to be drawn. The base material may be in the form of forecasts, existing plans or any past information about policies. The premises or assumptions must be the same for all and there should be total agreement on them. All managers involved in planning should be familiar with and use the same assumptions. For example, forecasting is important in developing premises as it is a technique of gathering information. Forecasts can be made about the demand for a particular product, policy change, interest rates, prices of capital goods, tax rates etc. Accurate forecasts, therefore become essential for successful plans.

(iii) **Identifying alternative courses of action:** Once objectives are set, assumptions are made. Then the next step would be to act upon them. There may be many ways to act and achieve objectives. All the alternative courses of action should be identified. The course of action which may be taken could be either routine or innovative. An innovative course may be adopted by involving more people and sharing their ideas. If the project is important, then more alternatives should be generated and thoroughly discussed amongst the members of the organisation.

(iv) **Evaluating alternative courses:** The next step is to weigh the pros and cons of each alternative. Each course will have many variables which have to be weighed against each other. The positive and negative aspects of each proposal need to be evaluated in the light of the objective to be achieved. In financial plans, for example, the risk-return trade-off is very common. The more risky the investment, the higher the returns it is likely to give. To evaluate such proposals detailed calculations of earnings, earnings per share, interest, taxes, dividends are made and decisions taken. Accurate forecasts in conditions of certainty/uncertainty then become vital assumptions for these proposals. Alternatives are evaluated in the light of their feasibility and consequences.

(v) **Selecting an alternative:** This is the real point of decision making. The best plan has to be adopted and implemented. The ideal plan, of course, would be the most feasible, profitable and with least negative consequences. Most plans may not always be subjected to a mathematical analysis. In such cases, subjectivity and the manager's experience, judgement and at times, intuition play an important part in selecting the most viable alternative. Sometimes, a combination of plans may be selected instead of one best course. The manager will have to apply permutations and combinations and select the best possible course of action.

(vi) **Implementing the plan:** This is the step where other managerial functions also come into the picture. The step is concerned with putting the plan into action, i.e., doing what is required. For example, if there is a plan to increase production then more labour, more machinery will be required. This step would also involve organising for labour and purchase of machinery.

(vii) **Follow-up action:** To see whether plans are being implemented and activities are performed according to schedule is also part of the planning process. Monitoring the plans is equally important to ensure that objectives are achieved.

Types of Plans

Single-use and standing plans

An organisation has to prepare a plan before making any decision related to business operation, or undertaking any project. Plans can be classified into several types depending on the use and the length of the planning period. Certain plans have a short-term horizon and help to achieve operational goals. These plans can be classified into single-use plans and standing plans.

Single-use Plan: A single-use plan is developed for a one-time event or project. Such a course of action is not likely to be repeated in future, i.e., they are for non-recurring situations. The duration of this plan may depend upon the type of the project. It may span a week or a month. A project may sometimes be of only one day, such as, organising an event or a seminar or conference. These plans include budgets, programmes and projects. They consist of details, including the names of employees who are responsible for doing the work and contributing to the single-use plan. For example, a programme may consist of identifying steps, procedures required for opening a new department to deal with other minor work. Projects are similar to programmes but differ in scope and complexity. A budget is a statement of expenses, revenue and income for a specified period.

Standing Plan: A standing plan is used for activities that occur regularly over a period of time. It is designed to ensure that internal operations of an organisation run smoothly. Such a plan greatly enhances efficiency in routine decision-making. It is usually developed once but is modified from time to time to meet business needs as required. Standing plans include policies, procedures, methods and rules.

Policies are general forms of standing plans that specifies the organisations response to a certain situation like the admission policy of an educational institution. Procedures describe steps to be followed in particular circumstances like the procedure for reporting progress in production. Methods provide the manner in which a task has to be performed. Rules are very clearly stated as to exactly what has to be done like reporting for work at a particular time.

Single-use and standing plans are part of the operational planning process.

There are other types of plans which usually are not classified as single-use or standing plans. A strategy, for example, is part of strategic planning or management. It is a general plan prepared by top management outlining resource allocation, priorities and takes into consideration the business environment and competition. Objectives are usually set by the top management and serve as a guide for overall planning. Each unit then formulates their own objectives keeping in view the overall organisational goals.

Based on what the plans seek to achieve, plans can be classified as Objectives, Strategy, Policy, Procedure, Method, Rule, Programme, Budget.

Objectives

The first step in planning is setting objectives. Objectives, therefore, can be said to be the desired future position that the management would like to reach. Objectives are very basic to the organisation and they are defined as ends which the management seeks to achieve by its operations. Therefore, an objective simply stated is what you would like to achieve, i.e., the end result of activities. For example, an organisation may have an objective of increasing sales by 10% or earning a reasonable rate of return on investment, earn a 20% profit from business. They represent the end point of planning. All other managerial activities are also directed towards achieving these objectives. They are usually set by top management of the organisation and focus on broad, general issues. They define the future state of affairs which the organisation strives to realise. They serve as a guide for overall business planning. Different departments or units in the organisation may have their own objectives.

Objectives need to be expressed in specific terms i.e., they should be measurable in quantitative terms, in the form of a written statement of desired results to be achieved within a given time period.

Strategy

A strategy provides the broad contours of an organisation's business. It will also refer to future decisions defining the organisations direction and scope in the long run. Thus, we can say a strategy is a comprehensive plan for accomplishing an organisation objectives. This comprehensive plan will include three dimensions, (i) determining long term objectives, (ii) adopting a particular course of action, and (iii) allocating resources necessary to achieve the objective.

Whenever a strategy is formulated, the business environment needs to be taken into consideration. The changes in the economic, political, social, legal and technological environment will affect an organisation's strategy. Strategies usually take the course of forming the organisation's identity in the business environment. Major strategic decisions will include decisions like whether the organisation will continue to be in the same line of business, or combine new lines of activity with the existing business or seek to acquire a dominant position in the same market. For example, a company's marketing strategy has to address certain questions i.e., who are the customers? what is the demand for the product? which channel of distribution to use? what is the pricing policy? and how do we advertise the product. These and many more issues need to be resolved while formulating a marketing strategy for any organisation.

Policy

Policies are general statements that guide thinking or channelise energies towards a particular direction. Policies provide a basis for interpreting strategy which is usually stated in general terms. They are guides to managerial action and decisions in the implementation of strategy. For example, the company may have a recruitment policy, pricing policy within which objectives are set and decisions are made. If there is an established policy, it becomes easier to resolve problems or issues. As such, a policy is the general response to a particular problem or situation.

There are policies for all levels and departments in the organisation ranging from major company policies to minor policies. Major company policies are for all to know i.e., customers, clients, competitors etc., whereas minor polices are applicable to insiders and contain minute details of information vital to the employees of an organisation. But there has to be some basis for divulging information to others.

Policies define the broad parameters within which a manager may function. The manager may use his/her discretion to interpret and apply a policy. For example, the decisions taken under a Purchase Policy would be in the nature of manufacturing or buying decisions. Should a company make or buy its requirements of packages, transport services, printing of stationery, water and power supply and other items? How should vendors be selected for procuring supplies? How many suppliers should a company make purchases from? What is the criteria for choosing suppliers. All these queries would be addressed by the Purchase Policy.

Procedure

Procedures are routine steps on how to carry out activities. They detail the exact manner in which any work is to be performed. They are specified in a chronological order. For example, there may be a procedure for requisitioning supplies before production. Procedures are specified steps to be followed in particular circumstances. They are generally meant for insiders to follow. The sequence of steps or actions to be taken are generally to enforce a policy and to attain pre-determined objectives. Policies and procedures are interlinked with each other. Procedures are steps to be carried out within a broad policy framework.

Method

Methods provide the prescribed ways or manner in which a task has to be performed considering the objective. It deals with a task comprising one step of a procedure and specifies how this step is to be performed. The method may vary from task to task. Selection of proper method saves time, money and effort and increases efficiency. For imparting training to employees at various level from top management to supervisory, different methods can be adopted. For example for higher level management orientation programmes, lectures and seminars can be organised whereas at the supervisory level, on the job training methods and work-oriented methods are appropriate.

Rule

Rules are specific statements that inform what is to be done. They do not allow for any flexibility or discretion. It reflects a managerial decision that a certain action must or must not be taken. They are usually the simplest type of plans because there is no compromise or change unless a policy decision is taken.

Programme

Programmes are detailed statements about a project which outlines the objectives, policies, procedures, rules, tasks, human and physical resources required and the budget to implement any course of action. Programmes will include the entire gamut of activities as well as the organisation's policy and how it will contribute to the overall business plan. The minutest details are worked out i.e., procedures, rules, budgets, within the broad policy framework.

Budget

A budget is a statement of expected results expressed in numerical terms. It is a plan which quantifies future facts and figures. For example, a sales budget may forecast the sales of different products in each area for a particular month. A budget may also be prepared to show the number of workers required in the factory at peak production times.

Since budget represents all items in numbers, it becomes easier to compare actual figures with expected figures and take corrective action subsequently. Thus, a budget is also a control device from which deviations can be taken care of. But making a budget involves forecasting, therefore, it clearly comes under planning. It is a fundamental planning instrument in many organisations.

Let us take an example of Cash Budget. The cash budget is a basic tool in the management of cash. It is a device to help the management to plan and control the use of cash. It is a statement showing the estimated cash inflows and cash outflows over a given period. Cash inflows would generally come from cash sales and the cash outflows would generally be the costs and expenses associated with the operations of the business. The net cash position is determined by the cash budget i.e., inflows minus (–) outflows = surplus or deficiency.

The management has to hold adequate cash balances for various purposes. But at the same time, it should avoid excess balance of cash since it gives little or no return. The business has to assess and plan its need for cash with a degree of caution.

Key Terms

Planning | Objectives | Goals | Decisions

Standards | Controlling | Premises | Assumptions

Alternatives | Strategy | Policy | Procedure

Rule | Programme | Budget

Summary

Planning
Planning is deciding in advance what to do and how to do. It is one of the basic managerial functions.
Planning therefore involves setting objectives and developing an appropriate course of action to achieve these objectives.

Importance of Planning
Planning provides directions, reduces risks of uncertainty, reduces overlapping and wasteful activities, promotes innovative ideas, facilitates decision making, establishes standards for controlling.

Features of Planning
Planning focuses on achieving objectives; It is a primary function of management; Planning is pervasive, continuous, futuristic and involves decision making; It is a mental exercise.

Limitations of Planning

Planning leads to rigidity; reduces creativity; involves huge costs; It is a time consuming process; Planning does not work in a dynamic environment; and does not guarantee success.

Planning Process

Setting objectives: Objectives may be set for the entire organisation and each department or unit within the organisation.

Developing premises: Planning is concerned with the future which is uncertain and every planner is using conjucture about what might happen in future.

Identifying alternative courses of action: Once objectives are set, assumptions are made. Then the next step would be to act upon them.

Evaluating alternative courses: The next step is to weigh the pros and cons of each alternative.

Selecting an alternative: This is the real point of decision making. The best plan has to be adopted and implemented.

Implement the plan: This is concerned with putting the plan into action.

Follow-up action: Monitoring the plans are equally important to ensure that objectives are achieved.

Types of Plans

Objectives: Objectives therefore can be said to be the desired future position that the management would like to reach.

Strategy: A strategy provides the broad contours of an organisation's business. It will also refer to future decisions defining the organisations direction and scope in the long run.

Policy: Policies are general statements that guide thinking or channelise energies towards a particular direction.

Procedure: Procedures are routine steps on how to carry out activities.

Rule: Rules are specific statements that tell what is to be done.

Programme: Programmes are detailed statements about a project which outlines the objectives, policies, procedures, rules, tasks, human and physical resources required and the budget to implement any course of action.

Budget: A budget is a statement of expected results expressed in numerical terms. It is a plan which quantifies future facts and figures.

Exercises

Short Answer Type

1. What are the main points in the definition of planning.
2. How does planning provide direction?

3. Do you think planning can work in a changing environment?
4. If planning involves working out details for the future, why does it not ensure success?
5. Why are rules considered to be plans?
6. What kind of strategic decisions are taken by business organisations.

Long Answer Type

1. Why is it that organisations are not always able to accomplish all their objectives?
2. What are the main features to be considered by the management while planning?
3. What are the steps taken by management in the planning process?
4. Is planning actually worth the huge costs involved? Explain.

Activities

Interview a local small-business manager about how their objectives are set and the time taken to achieve them. How do their answers compare with what you have learnt in the chapter.

Case Problem

An auto company C Ltd. is facing a problem of declining market share due to increased competition from other new and existing players in the market. Its competitors are introducing lower priced models for mass consumers who are price sensitive. For quality conscious consumers, the company is introducing new models with added features and new technological advancements.

Questions

1. Prepare a model business plan for C Ltd. to meet the existing challenge. You need not be very specific about quantitative parameters. You may specify which type of plan you are preparing.
2. Identify the limitations of such plans.
3. How will you seek to remove these limitations?

ORGANISING

5 CHAPTER

Way To Go, Wipro!

It's not quite there yet, but the goal is certainly within reach. One of India's largest IT solutions providers, Wipro Technologies, is taking on the likes of IBM and Accenture in its effort to be included among the largest and most successful technology services companies in the world.

Currently Wipro employs 45,000 people at a growth rate of 30 percent annually over the coming years. "I don't see growing to 150,000 or 200,000 people as an insurmountable challenge," said Premji, Chairman, Wipro. He believes that if companies such as Accenture could grow by 20,000 people in two years, Wipro's growth projections are not impossible.

Restructuring Wipro was considered the most important step in becoming a global giant, driven by the goal towards improved customer-orientation.

During the past few months, Wipro separated itself into several subsidiaries by product line: telecommunications, engineering, financial services, etc. Each subsidiary brings in about $300 million in annual earnings and is self-sufficient with their own accounting books, personnel and administrative functions.

Wipro shifted from a centralised to decentralised management system. All responsibilities for growth lay with the management of each entity.

"We tried to de-layer the organisation and empower our business leaders with a much higher degree of growth responsibility," said Premji. "We removed an entire layer [of executives]".

Between 2002 and 2003, Wipro acquired two IT consulting firms to break into the U.S. market. Wipro is also moving from a service provider to a product developer. Today, it partners with other companies to develop IT products to gain experience and achieve name recognition.

Adapted from an article by Heide B. Malhotra for Epoch Times Washington D.C. May 01, 2006

LEARNING OBJECTIVES

After studying this chapter you should be able to:

- Explain the concept of organising;
- Explain the process of organising;
- Describe the importance of organising;
- Explain the meaning, advantages and disadvantages of functional organisation;
- Explain the meaning, advantages and disadvantages of divisional organisation;
- Explain the meaning, advantages and disadvantages of formal and informal organisation;
- Distinguish between formal and informal organisation;
- Explain the concept of delegation and decentralisation;
- Describe the importance of delegation and decentralisation; and
- Distinguish between delegation and decentralisation.

Once the plans have been laid down and objectives specified therein, the next step is to organise resources in a manner which leads to the accomplishment of objectives. A critical issue in accomplishing the goals specified in the planning process is structuring the work of an organisation to adapt to the dynamic business environment. The activities of an enterprise must be organised in such a manner that plans can be successfully implemented.

For planning to be fruitful a number of considerations like resources that will be needed, optimum utilisation of the same translation of work into attainable tasks, empowering the workforce to accomplish these tasks etc., need to be understood and dealt with properly.

It is evident from the way Wipro has moved towards reaching for it's goal of becoming a globally successful technology company, that organising plays a significant role in implementation of plans.

What has Wipro done to become a contending force among other global giants? Are there lessons to be learnt from Wipro's approach?

Wipro organised itself in a manner that allowed customer orientation to dominate over other goals and diversified on the basis of product lines. It also modified the relationships within the management hierarchy to suit the goals.

The management function of organising ensures that efforts are directed towards the attainment of goals laid down in the planning function in such a manner that resources are used optimally and people are able to work collectively and effectively for a common purpose. Thus, it is in the context of effective management that the organisation function earns due importance. It is a means for translating plans into action.

The organising function leads to the creation of an organisational structure which includes the designing of roles to be filled by suitably skilled people and defining the inter relationship between these roles so that ambiguity in performance of duties can be eliminated. Not only is this important for productive cooperation between the personnel but also for clarification of extent of authority, as well as responsibility for results and logical grouping of activities.

Meaning

Let us take an example to understand how organising takes place. Have you ever paid attention to how, the school fete which you enjoy so much, actually takes place? What goes on behind the scene to make it the desired reality you want? The whole activity is divided into task groups each dealing with a specific area like the food committee, the decoration committee, the ticketing committee and so on. These are under the overall supervision of the official in charge of the event. Coordinating relationships are established among the various groups to enable smooth interaction and clarity about each group's contribution towards the event. All the above activities are a part of the organising function.

Organising essentially implies a process which coordinates human efforts, assembles resources and integrates both into a unified whole to be utilised for achieving specified objectives.

Organising can be defined as a process that initiates implementation of plans by clarifying jobs and working relationships and effectively deploying resources for attainment of identified and desired results (goals).

Steps in the Process of Organising

Organising involves a series of steps that need to be taken in order to achieve the desired goal. Let us try and understand how organising is carried out with the help of an example.

Suppose twelve students work for the school library in the summer vacations. One afternoon they are told to unload a shipment of new releases, stock the bookshelves, and then dispose of all waste (packaging, paper etc). If all the students decide to do it in their own way, it will result in mass confusion. However, if one student supervises the work by grouping students, dividing the work, assigning each group their quota and developing reporting relationships among them, the job will be done faster and in a better manner.

From the above description, the following steps emerge in the process of organising:

(i) **Identification and division of work:** The first step in the process of organising involves identifying and dividing the work that has to be done in accordance with previously determined plans. The work is divided into manageable activities so that duplication can

Definition of Organising

Organising is the process of identifying and grouping the work to be performed, defining and delegating responsibility and authority, and establishing relationships for the purpose of enabling people to work most effectively together in accomplishing objectives.

Louis Allen

Organising is the process of defining and grouping the activities of the enterprise and establishing authority relationships among them.

Theo Haimman

Think About It

Your school must have various societies for extra-curricular activities like the dramatics society, the quiz club, the economics society, the debating society and so on. Observe and list the way they have organised their activities using division of labour, chain of communication and the levels they have adopted for reporting on work. How far is this similar to the process you have read about?

be avoided and the burden of work can be shared among the employees.

(ii) **Departmentalisation:** Once work has been divided into small and manageable activities then those activities which are similar in nature are grouped together. Such sets facilitate specialisation. This grouping process is called departmentalisation. Departments can be created using several criteria as a basis. Examples of some of the most popularly used basis are territory (north, south, west etc.) and products (appliances, clothes, cosmetics etc).

(iii) **Assignment of duties:** It is necessary to define the work of different job positions and accordingly allocate work to various employees. Once departments have been formed, each of them is placed under the charge of an individual. Jobs are then allocated to the members of each department in accordance to their skills and competencies. It is essential for effective performance that a proper match is made between the nature of a job and the ability of an individual. The work must be assigned to those who are best fitted to perform it well.

(iv) **Establishing reporting relationships:** Merely allocating work is not enough. Each individual should also know who he has to take orders from and to whom he is accountable. The establishment of such clear relationships helps to create a hierarchal structure and helps in coordination amongst various departments.

IMPORTANCE OF ORGANISING

Performance of the organising function can pave the way for a smooth transition of the enterprise in accordance with the dynamic business environment. The significance of the organising function mainly arises from the fact that it helps in the survival and growth of an enterprise and equips it to meet various challenges. In order for any business enterprise to perform tasks and successfully meet goals, the organising function must be properly performed. The following points highlight the crucial role that organising plays in any business enterprise:

(i) **Benefits of specialisation:** Organising leads to a systematic allocation of jobs amongst the work force. This reduces the workload as well as enhances productivity because of the specific workers performing a specific job on a regular basis. Repetitive performance of a particular task allows a worker to gain experience in that area and leads to specialisation.

(ii) **Clarity in working relationships:** The establishment of working relationships clarifies lines of communication and specifies who is to report to whom. This removes ambiguity in transfer of information and instructions. It helps in creating a hierarchical order thereby enabling the fixation of responsibility and specification of the extent of authority to be exercised by an individual.

(iii) **Optimum utilization of resources:** Organising leads to the proper usage of all material, financial and human resources. The proper assignment of jobs avoids overlapping of work and also makes possible the best use of resources. Avoidance of duplication of work helps in preventing confusion and minimising the wastage of resources and efforts.

(iv) **Adaptation to change:** The process of organising allows a business enterprise to accommodate changes in the business environment. It allows the organisation structure to be suitably modified and the revision of inter-relationships amongst managerial levels to pave the way for a smooth transition. It also provides much needed stability to the enterprise as it can then continue to survive and grow inspite of changes.

(v) **Effective administration:** Organising provides a clear description of jobs and related duties. This helps to avoid confusion and duplication. Clarity in working relationships enables proper execution of work. Management of an enterprise thereby becomes easy and this brings effectiveness in administration.

(vi) **Development of personnel:** Organising stimulates creativity amongst the managers. Effective delegation allows the managers to reduce their workload by assigning routine jobs to their subordinates. The reduction in workload by delegation is not just necessary because of limited capacity of an individual but also allows the manager to develop new methods and ways of performing tasks. It gives them the time to explore areas for growth and the opportunity to innovate thereby

Think About It

Organising leads to specialisation in work. A pitfall of this is that repetitive performance of the same job may lead to monotony, stress, boredom and absenteeism. What can managers do to improve the scenario?

strengthening the company's competitive position. Delegation also develops in the subordinate the ability to deal effectively with challenges and helps them to realise their full potential.

(vii) **Expansion and growth:** Organising helps in the growth and diversification of an enterprise by enabling it to deviate from existing norms and taking up new challenges.

It allows a business enterprise to add more job positions, departments and even diversify their product lines. New geographical territories can be added to current areas of operation and this will help to increase customer base, sales and profit.

Thus, organising is a process by which the manager brings order out of chaos, removes conflict among people over work or responsibility sharing and creates an environment suitable for teamwork.

Organisation Structure

Organisation structure is the outcome of the organising process. An effective structure will result in increased profitability of the enterprise. The need for an adequate organisation structure is felt by an enterprise whenever it grows in size or complexity. It is only those enterprises which do not focus on growth that can maintain a particular structure for a long period of time. However, it is important to understand that such stagnancy may prove to be detrimental to an enterprise as those companies which do not change at all will close down or cease to grow.

As an organisation grows, coordination becomes difficult due to the emergence of new functions and increase in structural hierarchies. Thus, for an organisation to function smoothly and face environmental changes, it becomes necessary to pay attention to its structure.

Peter Drucker emphasises on the importance of having an appropriate organisation structure when he says, "organisation structure is an indispensable means; and the wrong structure will seriously impair business performance and even destroy it."

The organisation structure can be defined as the framework within which managerial and operating tasks are performed. It specifies the relationships between people, work and resources. It allows correlation and coordination among human, physical and financial resources and this enables a business enterprise to accomplish desired goals. The organisation structure of a firm is shown in an organisation chart.

The span of management, to a large extent gives shape to the organisational structure. Span of management refers to the number of subordinates that can be effectively managed by a superior. This determines the levels of management in the structure.

A proper organisation structure is essential to ensure a smooth flow of communication and better control over the operations of a business enterprise.

An organisation structure provides the framework which enables the enterprise to function as an integrated unit by regulating and coordinating the responsibilities of individuals and departments. Let us try and understand this through an example.

For example: Smita opened her own travel agency, sometime back. She assigned work to her three employees in the following manner 'Neha, you are incharge of air plane, train and bus reservations.' 'Karan, you will take care of accommodation booking'

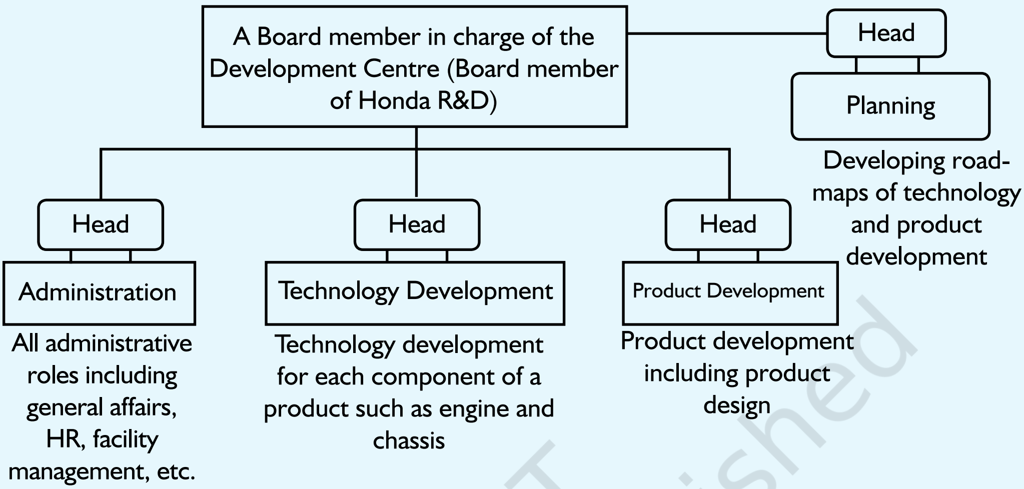
Honda to Strengthen Structure of its R&D Operations

Corporate February 21, 2006

TOKYO, Japan, February 21, 2006 – Honda Motor Co. Ltd. announced plans, effective April 1, 2006, to launch a new organisational structure for Honda R&D Co. Ltd., a wholly owned subsidiary of Honda responsible for research & development activities. Due to recent technological advancements and continued business expansion, the variety and complexity of technological components and the number of vehicles under development at Honda R&D have increased dramatically. The new structure will be launched both in response to this situation and to prepare for further expansion of business in the future. The new structure will enable each associate to demonstrate a high level of initiative, with more clear definition of roles and responsibilities and bold delegation of authority. Moreover, the new structure is designed to achieve smoother communication to help accelerate decision making within the organisation. The key elements of the new structure are as follows:

Outline of the New Structure:

1. Existing R&D centers including Asaka R&D Center, Wako R&D Center, and Tochigi R&D Center, which are currently organised based on geographical location and will be reorganised into five centers based on specific functions. The names of the five centers will be Motorcycle Development Center, Automobile Development Center, Power Products Development Center, Aero Engine Development Center, and Basic Technology Research Center.
2. Each center will have separate offices for planning, product development, technology development and administration with clearly defined roles.
3. Primary authority to make operational decisions, currently held by the head of each center,



will be delegated to the head of each office within each center to achieve an autonomous operational structure through which each office can make more decisions.

4. A flat and less-layered organisational structure will be employed to ensure smooth and direct communications between the head of the office and each associate.
5. The product development function of the Automobile Development Center will be further separated between the Honda brand and Acura brand.

This structural change is a part of Honda's continuous effort to strengthen the core characteristics that makes Honda unique, and its purpose is to continue creating advanced and creative technologies and products that are unique to Honda, which in turn will enable Honda to continue to be a company that society wants to exist.

http://world.honda.com/news/2006/c060221RandDOperations/

'Sahil, you will keep track of online queries and credit card payments'. I want regular reports from the three of you. Thus, in a few sentences an organisation structure has been created specifying lines of authority and areas of responsibility.

Types of Organisation Structures

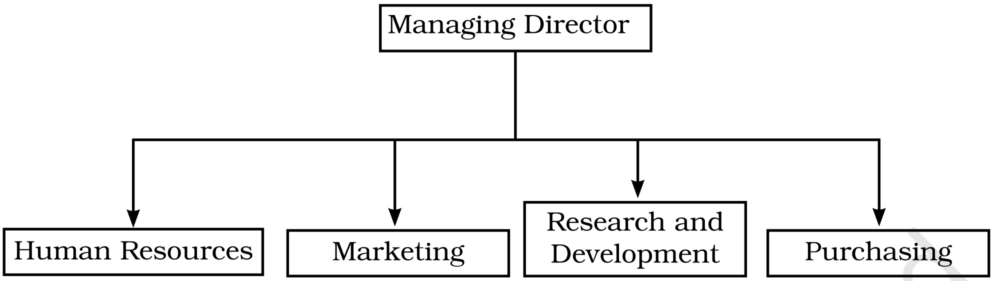
The type of structure adopted by an organisation will vary with the nature and types of activities performed by an organsation. The organisational structure can be classified under two categories which are as follows:

(i) Functional structure and
(ii) Divisional structure

Functional structure

Grouping of jobs of similar nature under functional and organising these major functions as separate departments creates a functional

Functional Structure



structure. All departments report to a coordinating head. For example, in a manufacturing concern division of work into key functions will include production, purchase, marketing, accounts and personnel. These departments may be further divided into sections. Thus, a functional structure is an organisational design that groups similar or related jobs together.

Advantages: The functional structure has many advantages to offer. Important among them are as follows:

(a) A functional structure leads to occupational specialisation since emphasis is placed on specific functions. This promotes efficiency in utilisation of manpower as employees perform similar tasks within a department and are able to improve performance.

(b) It promotes control and coordination within a department because of similarity in the tasks being performed.

(c) It helps in increasing managerial and operational efficiency and this results in increased profit.

(d) It leads to minimal duplication of effort which results in economies of scale and this lowers cost.

(e) It makes training of employees easier as the focus is only on a limited range of skills.

(f) It ensures that different functions get due attention.

Disadvantages: The functional structure has certain disadvantages which an organisation must take into consideration before it adopts it. Some of them are as follows:

(a) A functional structure places less emphasis on overall enterprise objectives than the objectives pursued by a functional head. Such practices may lead to functional empires wherein the importance of a particular function may be overemphasised. Pursuing departmental interests at the cost of organisational interests can also hinder the interaction between two or more departments.

(b) It may lead to problems in coordination as information has to

Think About It

Read newspapers regularly and try to identify the structures various business organisations being mentioned in the news have adopted. Have their structures led to improved and desired results in any way?

be exchanged across functionally differentiated departments.

(c) A conflict of interests may arise when the interests of two or more departments are not compatible. For example, the sales department insisting on a customer friendly design may cause difficulties in production. Such dissension can prove to be harmful in terms of fulfillment of organisational interest. Inter-departmental conflicts can also arise in the absence of clear separation of responsibility.

(d) It may lead to inflexibility as people with same skills and knowledge base may develop a narrow perspective and thus, have difficulty in appreciating any other point of view. Functional heads do not get training for top management positions because they are unable to gather experience in diverse areas.

Suitability: It is most suitable when the size of the organisation is large, has a diversified activities and operations require a high degree of specialisation.

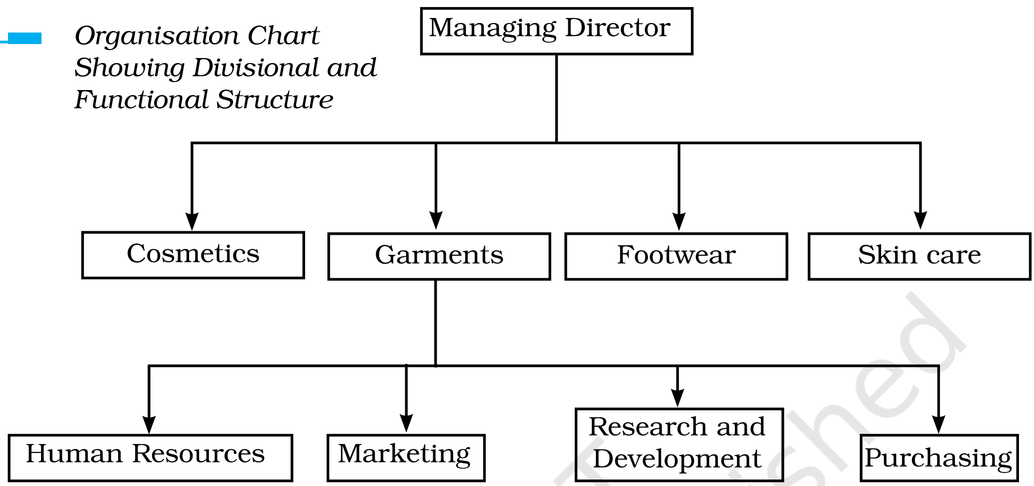
Divisional Structure

Many large organisations with diversified activities have reorganised themselves away from the simpler and basic functional structure towards a divisional structure which is more suited to their activities. This is particularly true of those enterprises which have more than one category of products to offer. This is because although every organisation performs a set of homogenous functions, as it diversifies into varied product categories, the need for a more evolved structural design is felt to cope with the emerging complexity.

In a divisional structure, the organisation structure comprises of separate business units or divisions. Each unit has a divisional manager responsible for performance and who has authority over the unit. Generally, manpower is grouped on the basis of different products manufactured. Each division is multifunctional because within each division functions like production, marketing, finance, purchase etc, are performed together to achieve a common goal. Each division is self-contained as it develops expertise in all functions related to a product line.

In order words, within each division, the functional structure tends to be adopted. However, functions may vary across divisions in accordance with a

Organisation Chart Showing Divisional and Functional Structure



particular product line. Further, each division works as a profit center where the divisional head is responsible for the profit or loss of his division. For example, a large company may have divisions like cosmetics, clothing etc.

Advantages: The divisional structure offers many benefits. Prominent among these are as follows:

(a) Product specialisation helps in the development of varied skills in a divisional head and this prepares him for higher positions. This is because he gains experience in all functions related to a particular product.

(b) Divisional heads are accountable for profits, as revenues and costs related to different departments can be easily identified and assigned to them. This provides a proper basis for performance measurement. It also helps in fixation of responsibility in cases of poor performance of the division and appropriate remedial action can be taken.

(c) It promotes flexibility and initiative because each division functions as an autonomous unit which leads to faster decision making.

(d) It facilitates expansion and growth as new divisions can be added without interrupting the existing operations by merely adding another divisional head and staff for the new product line.

Disadvantages: The divisional structure has certain disadvantages. Some of them are as follows:

(a) Conflict may arise among different divisions with reference to allocation of funds and further a particular division may seek to maximise its profits at the cost of other divisions.

(b) It may lead to increase in costs since there may be a duplication of activities across products.

Providing each division with separate set of similar functions increases expenditure.

(c) It provides managers with the authority to supervise all activities related to a particular division. In course of time, such a manager may gain power and in a bid to assert his independence may ignore organisational interests.

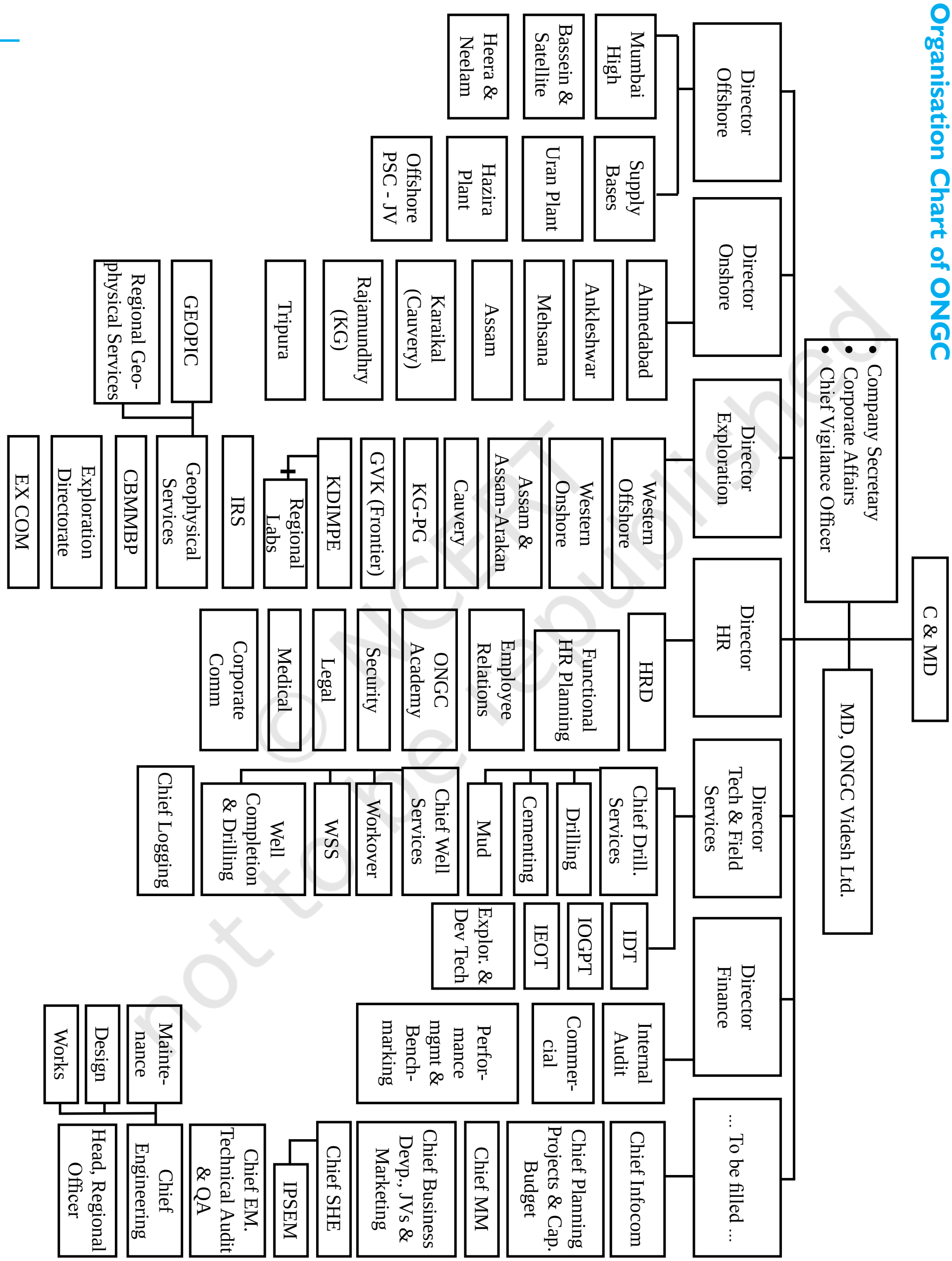
Suitability: Divisional structure is suitable for those business enterprises where a large variety of products are manufactured using different productive resources. When an organisation grows and needs to add more employees, create more departments and introduce new levels of management, it will decide to adopt a divisional structure. Table 1 provides a comparison of functional and divisional structure to provide further clarity on the topic.

Thus, it can be said that business operates in a dynamic environment and those enterprises which fail to adapt to change are unable to survive. Hence, management must continuously review its plans and objectives and accordingly the organisation structure of the enterprise should also be subjected to periodic review to determine if modification is required. An organisation structure, at all times should contribute towards the achievement of the enterprise's objectives and should provide scope

Comparative view: Functional and Divisional Structure

Basis	Functional Structure	Divisional Structure
Formation	Formation is based on functions	Formation is based on product lines and is supported by functions.
Specialisation	Functional specialisation.	Product specialisation.
Responsibility	Difficult to fix on a department.	Easy to fix responsiblity for performance.
Managerial Development	Difficult, as each functional manager has to report to the top management.	Easier, autonomy as well as the chance to perform multiple functions helps in managerial development.
Cost	Functions are not duplicated hence economical	Duplication of resources in various departments, hence costly.
Coordination	Difficult for a multi-product company.	Easy, because all functions related to a particular product are integrated in one department.

Organisation Chart of ONGC



Adapted from www.ongc.com/archives

Structural Transformation at ONGC

Since its inception, ONGC has been instrumental in transforming the country's limited upstream sector into a large viable playing field, with its activities spread throughout India and significantly in overseas territories.

The 1990s had begun on a grim note for ONGC. It took almost a decade for the Corporation to sort things out in most uncertain of times.

Among many problems, the Corporation was also suffering from the organisational atrophy. In order to survive ONGC sought help from Mc Kinsey.

Mc Kinsey's mandate was to evolve an organisational structure that was far more responsive to its business needs than that based on business groups. The ONGC system run by functional heads often meant delays exceeding a year in matters requiring urgent decisions on fields. Also, since responsibilities were shared at production platforms between different business groups, the system degenerated into wrangling over responsibilities. Similarly, group loyalties often took precedence over the requirements of tasks. But, most importantly, it was found that the performance evaluation criteria based on business group yardstick were completely at loggerheads with requirements on fields. Mc Kinsey recommended an asset-based approach with clearly-defined responsibilities in its presentation titled 'Organisation Transformation Project'

Though Mc Kinsey recommendations were broadly accepted, coordination issues concerning commonly-shared services needed to be sorted out.

Finally, the first control over all service personnel working with asset teams was vested in asset managers, on grounds that being responsible for the performance of their strategic business units they must rightfully exercise control over all personnel working with them. Even procurement powers were devolved. Finally, a new structure made up of 14 assets and 11 centralised services was rolled out .

Do It Yourself

You have seen the structure of ONGC as an illustration in this text. Browse the websites of other business organisations and study their organisational chart. Try to identify the structure they are using.

for initiative so that contribution of personnel can be maximum and effective.

Formal and Informal Organisation

In all organisations, employees are guided by rules and procedures. To enable smooth functioning of the enterprise, job description and rules and procedures related to work processes have to be laid down. This is done through the formal organisation.

Formal organisation refers to the organisation structure which is designed by the management to accomplish a particular task. It specifies clearly the boundaries of authority and responsibility and there is a systematic coordination among the various activities to achieve organisational goals.

The structure in a formal organisation can be functional or divisional. The formal organisation can be better understood by a study of its features which are as follows:

(a) It specifies the relationships among various job positions and the nature of their interrelationship. This clarifies who has to report to whom.

(b) It is a means to achieve the objectives specified in the plans, as it lays down rules and procedures essential for their achievement.

(c) Efforts of various departments are coordinated, interlinked and integrated through the formal organisation.

(d) It is deliberately designed by the top management to facilitate the smooth functioning of the organisation.

(e) It places more emphasis on work to be performed than interpersonal relationships among the employees.

Advantages: Formal organisation offers many advantages. Some of the important ones are:

(a) It is easier to fix responsibility since mutual relationships are clearly defined.

(b) There is no ambiguity in the role that each member has to play as duties are specified. This also helps in avoiding duplication of effort.

(c) Unity of command is maintained through an established chain of command.

(d) It leads to effective accomplishment of goals by providing a framework for the operations to be performed and ensuring that each employee knows the role he has to play.

(e) It provides stability to the organisation. This is because behaviour of employees can be fairly predicted since there are specific rules to guide them.

Limitations: The formal organisation suffers from the following limitations:

Formal Organisation

The formal organisation is a system of well-defined jobs, each bearing a definite measure of authority, responsibility and accountability.

Louis Allen

Formal organisation is a system of consciously coordinated activities of two or more persons toward a common objective.

Chester Barnand

(a) The formal communication may lead to procedural delays as the established chain of command has to be followed which increases the time taken for decision making.
(b) Poor organisation practices may not provide adequate recognition to creative talent, since it does not allow any deviations from rigidly laid down polices.
(c) It is difficult to understand all human relationships in an enterprise as it places more emphasis on structure and work. Hence, the formal organisation does not provide a complete picture of how an organisation works.

Informal Organisation

Interaction among people at work gives rise to a 'network of social relationships among employees' called the informal organisation.

Informal organisation emerges from within the formal organisation when people interact beyond their officially defined roles. When people have frequent contacts they cannot be forced into a rigid formal structure. Rather, based on their interaction and friendship they tend to form groups which show conformity in terms of interest. Examples of such groups formed with common interest may be those who take part in cricket matches on Sundays, meet in the cafeteria for coffee, are interested in dramatics etc. Informal organisation has no written rules, is fluid in form and scope and does not have fixed lines of communication. The Table in the next page compares informal organisation with the formal organisation to provide better understanding of both types.

Informal organisation can be better understood with the help of the following features:
(a) An informal organisation originates from within the formal organisation as a result of personal interaction among employees.
(b) The standards of behaviour evolve from group norms rather than officially laid down rules and regulations.
(c) Independent channels of communication without specified direction of flow of information are developed by group members.

Informal Organisation

An informal organisation is an aggregate of interpersonal relationships without any conscious purpose but which may contribute to joint results.

Chester Barnand

Informal organisation is a network of personal and social relations not established or required by the formal organisation but arising spontaneously as people associate with one another.

Keith Davis

(d) It emerges spontaneously and is not deliberately created by the management.
(e) It has no definite strucure or form because it is a complex network of social relationships among members.

Advantages: The informal organisation offers many benefits. Important among them are given below:

(a) Prescribed lines of communication are not followed. Thus, the informal organisation leads to faster spread of information as well as quick feedback.
(b) It helps to fulfill the social needs of the members and allows them to find like minded people. This enhances their job satisfaction since it gives them a sense of belongingness in the organisation.
(c) It contributes towards fulfillment of organisational objectives by compensating for inadequacies in the formal organisation. For example, employees reactions towards plans and policies can be tested through the informal network.

Disadvantages: The informal organisation has certain disadvantages. Some of them are as follows:

Formal and informal organisation: A Comparative view

Basis	Formal organisation	Informal organisation
Meaning	Structure of authority relationships created by the management	Network of social relationships arising out of interaction among employees
Origin	Arises as a result of company rules and policies	Arises as a result of social interaction
Authority	Arises by virtue of position in management	Arises out of personal qualities
Behavior	It is directed by rules	There is no set behaviour pattern
Flow of Communication	Communication takes place through the scalar chain	Flow of communication is not through a planned route. It can take place in any direction
Nature	Rigid	Flexible
Leadership	Managers are leaders.	Leaders may or may not be managers. They are chosen by the group.

(a) Informal organisation may become a disruptive force when it spreads rumours. This may work against the interest of the formal organisation.

(b) The management may not be successful in implementing changes if the informal organisation opposes them. Such resistance to change may delay or restrict growth.

(c) It pressurises members to conform to group expectations. This can be harmful to the organisation if the norms set by the group are against organisational interests.

Informal organisation cannot be altogether eliminated. Thus, it would be in the best interest of the organisation if the existence of such groups is recognised and the roles that their members play are identified. The knowledge of such groups can be used to gather their support and consequently lead to improved organisational performance. Such groups can also provide useful communication channels. Instead of confronting them, the management should skillfully take advantage of both the formal and informal organisation so that work continues smoothly.

Delegation

A manager, no matter how capable he is, cannot manage to do every task on his own. The volume of work makes it impractical for him to handle it all by himself. As a consequence, if he desires to meet the organisational goals, focus on objectives and ensure that all work is accomplished, he must delegate authority.

Delegation refers to the downward transfer of authority from a superior to a subordinate. It is a pre-requisite to the efficient functioning of an organisation because it enables a manager to use his time on high priority activities. It also satisfies the subordinate's need for recognition and provides them with opportunities to develop and exercise initiative.

Delegation

Delegation is the process a manager follows in dividing the work assigned to him so that he performs that part which only he because of his unique organisational placement, can perform effectively and so that he can get others to help with what remains.

Louis Allen

Delegation of authority merely means the granting of authority to subordinates to operate within prescribed limits.

Theo Haimman

Delegation helps a manager to extend his area of operations as without it, his activities would be restricted to only what he himself can do. However, delegation does not mean abdication. The manager shall still be accountable for the performance of the assigned tasks. Moreover, the authority granted to a subordinate can be taken back and redelegated to another person. Thus, irrespective of the extent of delegated authority ,the manager shall still be accountable to the same extent as before delegation.

Elements of Delegation

According to Louis Allen, delegation is the entrustment of responsibility and authority to another and the creation of accountability for performance.

A detailed analysis of Louis Allen's definition brings to light the following essential elements of delegation:

(i) ***Authority:*** Authority refers to the right of an individual to command his subordinates and to take action within the scope of his position. The concept

No delegation leads to delays in decision-making

Creation of accountability for performance

of authority arises from the established scalar chain which links the various job positions and levels of an organisation. Authority also refers to the right to take decisions inherent in a managerial position to tell people what to do and expect them to do it.

In the formal organisation authority originates by virtue of an individual's position and the extent of authority is highest at the top management levels and reduces successively as we go down the corporate ladder. Thus, authority flows from top to bottom, i.e., the superior has authority over the subordinate.

Authority relationships helps to maintain order in the organisation by giving the managers the right to exact obedience and give directions to the workforce under them.

Authority determines the superior subordinate relationship wherein the superior communicates his decision to the subordinate, expecting compliance from him and the subordinate executes the decision as per the guidelines of the superior. The extent to which a superior can exact compliance also depends on the personality of the superior.

It must be noted that authority is restricted by laws and the rules and regulation of the organisation, which limit its scope. However, as we go higher up in the management hierarchy, the scope of authority increases.

(ii) ***Responsibility:*** Responsibility is the obligation of a subordinate to properly perform the assigned duty. It arises from a superior–subordinate relationship because the subordinate is bound to perform the duty assigned to him by his superior. Thus, responsibility flows upwards i.e., a subordinate will always be responsible to his superior.

An important consideration to be kept in view with respect to both authority and responsibility is that when an employee is given responsibility for a job he must also be given the degree of authority necessary to carry it out. Thus, for effective delegation the authority granted must be commensurate with the assigned responsibility. If authority granted is more than responsibility, it may lead to misuse of authority, and if responsibility assigned is more than authority it may make a person ineffective.

(iii) ***Accountability:*** Delegation of authority, undoubtedly empowers an employee to act for his superior but the superior would still be accountable for the outcome:

Accountability implies being answerable for the final outcome. Once authority has been delegated and responsibility accepted, one cannot deny accountability. It cannot be delegated and flows upwards i.e., a subordinate will be accountable to a superior for satisfactory performance of work. It indicates that the manager has to ensure the proper discharge of duties by his subordinates. It is generally enforced through regular feedback on the extent of work accomplished. The subordinate will be

Overview of the elements of delegation

Basis	Authority	Responsibility	Accountability
Meaning	Right to command.	Obligation to perform an assigned task.	Answerability for outcome of the assigned task.
Delegation	Can be delegated.	Cannot be entirely delegated.	Cannot be delegated at all.
Origin	Arises from formal position .	Arises from delegated authority.	Arises from responsibility.
Flow	Flows downward from superior to subordinate.	Flows upward from subordinate to superior.	Flows upward from subordinate to superior

expected to explain the consequences of his actions or omissions.

In conclusion, it can be stated that while authority is delegated, responsibility is assumed, accountability is imposed. Responsibility is derived from authority and accountability is derived from responsibility. The Table in the

Interview with Azim Premji

knowledge.wharton.upenn.edu: April 20, 2006

Azim Premji, owns more than 80 per cent of Bangalore-based Wipro, India's third largest software exporter, which had annual revenues of US $ 1.8 billion in 2005. Forbes magazine reckons that his net worth exceeds US $ 13 billion, and it places him at No. 25 in its most recent ranking of the world's richest people. Premji speaks with Ravi Aron, a professor of operations and information management at Wharton about Wipro's reorganisation.

Aron: After Vivek Paul [Wipro's former CEO] left the company last year, you made radical changes in your organisational structure. How did they affect your markets and your vision for where Wipro is going?

Premji: The most important thing you must appreciate is that, with the reorganisation, we tried to bring Wipro's leadership closer to the customer. In the process, we tried to de-layer the organisation and empower our business leaders. That is why we removed an entire layer which was there previously. Our executives are seasoned enough in their jobs and they have performed long enough in their roles to be confident that they can deliver results through the new structure.

Aron: As part of your new structure, have you started redefining the organisation with P&L responsibility at the level of the vertical? [Editor's note: Wipro's vertical structure divides the company into units such as Telecom Service Providers, Product Engineering Solutions, Finance Solutions, and Enterprise Solutions. These units further cater to industries such as banking, insurance, securities, and so on.]

Premji: No. Each vertical is like a self-contained business. It is like a mid-sized company even by U.S. standards, because each vertical generates about $300 million in annual revenues. Though they work under a common structure, with resources such as Finance, HR, Quality and Marketing, each vertical has people who represent these functions. So, in effect, each vertical is like a separate company.

Aron: Does that mean you intend to delegate more authority and responsibility to these self-contained companies?

Premji: Absolutely.

Aron: What is your thinking behind this?

Premji: It all goes back to leadership. It speeds things up and gets decisions made faster. It empowers people more, and it allows them to further empower those who report to them, because their jobs have suddenly become much more responsible.

http://www.ibef.org/artdisplay.aspx?cat_id=105&art_id=11158

previous page provides a summarised view of the elements of delegation.

Importance of Delegation

Delegation ensures that the subordinates perform tasks on behalf of the manager thereby reducing his workload and providing him with more time to concentrate on important matters. Effective delegation leads to the following benefits:

(i) **Effective management:** By empowering the employees, the managers are able to function more efficiently as they get more time to concentrate on important matters. Freedom from doing routine work provides them with opportunities to excel in new areas.

(ii) **Employee development:** As a result of delegation, employees get more opportunities to utilise their talent and this may give rise to latent abilities in them. It allows them to develop those skills which will enable them to perform complex tasks and assume those responsibilities which will improve their career prospects. It makes them better leaders and decision makers. Thus, delegation helps by preparing better future managers. Delegation empowers the employees by providing them with the chance to use their skills, gain experience and develop themselves for higher positions.

(iii) **Motivation of employees:** Delegation helps in developing the talents of the employees. It also has psychological benefits. When a superior entrusts a subordinate with a task, it is not merely the sharing of work but involves trust on the superior's part and commitment on the part of the subordinate. Responsibility for work builds the self-esteem of an employee and improves his confidence. He feels encouraged and tries to improve his performance further.

(iv) **Facilitation of growth:** Delegation helps in the expansion of an organisation by providing a ready workforce to take up leading positions in new ventures. Trained and experienced employees are able to play significant roles in the launch of new projects by replicating the work ethos they have absorbed from existing units, in the newly set up branches.

(v) **Basis of management hierarchy:** Delegation of authority establishes superior-subordinate relationships, which are the basis of hierarchy of management. It is the degree and flow of authority which determines who has to report to whom. The extent of delegated authority also decides the power that each job position enjoys in the organisation.

(vi) **Better coordination:** The elements of delegation, namely authority, responsibility and accountability help to define the powers, duties and answerability related to the various positions in an organisation. This helps to avoid overlapping of duties and

Innovation at HCL

The world's most modern management in India; HCL Technologies is empowering its employees and pointing the way to the future of business.Fortune, April 14, 2006.

Every employee rates their boss, their boss' boss, and any three other company managers they choose, on 18 questions using a 1-5 scale. Such 360-degree evaluations are not uncommon, but at HCL all results are posted online for every employee to see. That's un-heard-of!

And that's not all. Every HCL employee can at any time create an electronic 'ticket' to flag anything they think requires action in the company. Amazingly, such tickets can only be 'closed' by the employees themselves. And Nayar [Vineet Nayar is president of India's 30,000-employee HCL Technologies (Research)] is vigilant that managers not intimidate employees about creating or closing tickets. Managers are evaluated partly based on how many tickets their departments are creating - the more the better.

In addition, every employee can post a question or comment on any subject in a public process called 'U and I.' About 400 come in each month, and questions and answers are all posted on the intranet.

"I want to be the company that gives superior service to my employees compared to everybody else," he explains. He also firmly believes the ideas that will guide HCL into the future will come not from him, but from below. Early signs suggest his bold strategy is working. Nayar has only been president for a year, a tumultuous one in which most of these innovations have been implemented. But in that time the attrition rate has dropped in half, he says. HCL's innovations are not only managerial. The company aims to become a strategic partner with customers by working with them on business process management and by managing infrastructure remotely, a business it has pioneered in India, says Nayar. The strategy has succeeded with AMD (Research), a marquee customer for which the company does the above mentioned business. Another key customer is Cisco (Research), a 10-year customer with whom HCL is now embracing another form of innovation- shared risk. Since February, HCL has been completely responsible for engineering one Cisco product. It gets paid based on how well the product sells. In engineering all this innovation, Nayar's humility appears to be a potent managerial asset.

Adapted from an article by David Kirkpatrick on:
http://www.indianembassy.org/newsite/News/US%20Media/2006/115.asp

duplication of effort as it gives a clear picture of the work being done at various levels. Such clarity in reporting relationships help in developing and maintaining effective coordination amongst the departments, levels and functions of management.

Thus, delegation is a key element in effective organising.

Decentralisation

In many organisations the top management plays an active role in taking all decisions while there are others in which this power is given to even the lower levels of management. Those organisations in which decision making authority lies with the top management are termed as centralised organisations whereas those in which such authority is shared with lower levels are decentralised organisations.

Decentralisation explains the manner in which decision making responsibilities are divided among hierarchical levels. Put simply, decentralisation refers to delegation of authority throughout all the levels of the organisation. Decision making authority is shared with lower levels and is consequently placed nearest to the points of action. In other words decision making authority is pushed down the chain of command.

When decisions taken by the lower levels are numerous as well as important an organisation can be regarded as greatly decentralised.

Centralisation and Decentralisation

Centralisation and decentralisation are relative terms, as seen from the existing status of various business enterprises.

An organisation is centralised when decision-making authority is retained by higher management levels whereas it is decentralised when such authority is delegated.

Complete centralisation would imply concentration of all decision making functions at the apex of the management hierarchy. Such a scenario would obviate the need for a management hierarchy. On the other

Decentralisation

Decentralisation refers to systematic effort to delegate to the lowest level all authority except that which can be exercised at central points.

Louis Allen

Everything which goes to increase the importance of a subordinate's role is decentralisation, everything that goes to reduce it is centralisation.

Henri Fayol

hand, complete decentralisation would imply the delegation of all decision making functions to the lower level of the hierarchy and this would obviate the need for higher managerial positions. Both the scenarios are unrealistic.

An organisation can never be completely centralised or decentralised. As it grows in size and complexity , there is a tendency to move towards decentralised decision making. This is because in large organisations those employees who are directly and closely involved with certain operations tend to have more knowledge about them than the top management which may only be indirectly associated with individual operations.

Hence, there is a need for a balance between these co-existing forces. Thus, it can be said that every organisation will be characterised by both centralisation and decentralisation.

Importance

Decentralisation is much more than a mere transfer of authority to the lower levels of management hierarchy. It is a philosophy that implies selective dispersal of authority because it propagates the belief that people are competent, capable and resourceful. They can assume the responsibility for the effective implementation of their decisions .Thus this philosophy recognises the decision maker's need for autonomy. The management, however, needs to carefully select those decisions which will be pushed down to lower levels and those that will be retained for higher levels. Table 4 provides a comparative look between delegation and decentralisation.

Decentralisation is a fundamental step and its importance can be understood from the following points:

(i) **Develops initiative among subordinates:** Decentralisation helps to promote self-reliance and confidence amongst the subordinates. This is because when lower managerial levels are given freedom to take their own decisions they learn to depend on their own judgment. It also keeps them in a state wherein they are constantly challenged and have to develop solutions for the various problems they encounter. A decentralisation policy helps to identify those executives who have the necessary potential to become dynamic leaders.

(ii) **Develops managerial talent for the future:** Formal training plays an important part in equipping subordinates with skills that help them rise in the organisation but equally important is the experience gained by handling assignments independently. Decentralisation gives them a chance to prove their abilities and creates a reservoir of qualified manpower who can be considered to fill up more challenging positions through promotions. It also helps to identify those who may not be successful in assuming greater responsibility. Thus, it is a means of management education as well as an opportunity for trained manpower to use its talent in real life situations.

(iii) **Quick decision making:** The management hierarchy can be looked upon as a chain of communication. In centralised organisation because every decision is taken by the top management the flow of information is slow as it has to traverse many levels. Response also takes time. This reduces the speed of decision making and makes it difficult for an enterprise to adapt to dynamic operating conditions. In a decentralised organisation, however ,since decisions are taken at levels which are nearest to the points of action and there is no requirement for approval from many levels, the process is much faster. There are also less chances of information getting distorted because it doesn't have to go through long channels.

(iv) **Relief to top management:** Decentralisation diminishes the amount of direct supervision exercised by a superior over the activities of a subordinate because they are given the freedom to act and decide albeit within the limits set by the superior. Also, personal supervision is generally replaced by other forms of control such as return on investment etc. Decentralisation also leaves the top management with more time which they can devote to important policy decisions rather than occupying their time with both policy as well as operational decisions. In fact decentralisation is greatest when checking required on decisions taken by lower levels of management is least.

(v) **Facilitates growth:** Decentralisation awards greater autonomy to the lower levels of management as well as divisional or departmental heads. This allows them to function in a manner best suited to their department and fosters a sense of competition amongst the departments. Consequently, with each department doing its best in a bid to outdo the other, the productivity levels increase and the organisation is able to generate more returns which can be used for expansion purposes.

(vi) **Better control:** Decentralisation makes it possible to evaluate performance at each level and the departments can be individually held accountable for their results. The extent of achievement of organisational objectives as well as the contribution of each department in meeting the overall objectives can be ascertained. Feedback from all levels helps to analyse variances and improve operations. In decentralisation, one of the challenges is the accountability of performance. In response to this challenge, better control systems are being evolved such as the balance score card and management information system. Decentralisation compels the management to innovative performance measurement systems.

As a conclusion, it must be noted that in spite of its benefits decentralisation should be applied with caution as it can lead to organisational disintegration if the departments start to operate on their own guidelines which may be contrary to the interest of the

Decentralisation : A Strength

The McNeil name has been associated with the manufacturing and sale of pharmaceutical products since 1879, when Robert McNeil opened his first retail drug outlet in Pennsylvania. Growing as a producer of prescription pharmaceuticals, McNeil Laboratories, Inc. was incorporated in the U.S. in 1933, and became a member of the Johnson & Johnson family of companies in 1959. McNeil Consumer Healthcare began operations in Canada in an existing administrative Johnson & Johnson facility in Guelph, Ontario in 1980.

McNeil Consumer Healthcare (nonprescription pharmaceutical products) in Guelph, Ontario is a member of the Johnson & Johnson family of companies in Canada.

An important difference between Johnson & Johnson and most other companies — is the concept of decentralised management. Instead of operating as one large multi-billion dollar corporation, Johnson & Johnson is operated as 190 smaller companies, each focused on a specific medical or product franchise and/or geographic area, with each affiliate generating multiple options for growth. Through decentralisation we combine the advantages of being big with the agility and focus of smaller firms. Decentralisation enables each company to stay close to its customer, maintain short lines of communication with customers and employees, and accelerate the development of talent. The Johnson & Johnson - Merck Consumer Pharmaceuticals company also operates from our Woodlawn Road facility in Guelph.

http://www.mcneilcanada.com/eng/eco07pg1.shtm

Think About It

If you were a manager, would you decentralise, knowing that it would mean dispersal of decision making authority?

Delegation and Decentralisation: A Comparative view

Basis	Delegation	Decentralisation
Nature	Delegation is a compulsory act because no individual can perform all tasks on his own.	Decentralisation is an optional policy decision. It is done at the discretion of the top management.
Freedom of action	More control by superiors hence less freedom to take own decisions.	Less control over executives hence greater freedom of action.
Status	It is a process followed to share tasks.	It is the result of the policy decision of the top management.
Scope	It has narrow scope as it is limited to superior and his immediate subordinate.	It has wide scope as it implies extension of delegation to the lowest level of management.
Purpose	To lessen the burden of the manager.	To increase the role of the subordinates in the organisation by giving them more autonomy.

Key Terms

organisation. Decentralisation must always be balanced with centralisation in areas of major policy decisions.

Organising | Organisational structure

Departmentalisation | Delegation | Authority

Responsibility | Accountability | Functional structure

Divisional structure | Formal organisation

Informal organisation | Span of management

Centralisation | Decentralisation

Summary

Organising is the process of defining and grouping activities and establishing authority relationships among them.
Process: the process of organising consists of the following steps:

(a) Identification and division of work

(b) Departmentalisation

(c) Assignment of Duties

(d) Establishing reporting relationships

Importance: Organising is considered important because it leads to division of work, clarity in reporting relationships, optimum utilization of resources, growth, better administration and greater creativity.

Organisational structure is the framework within which managerial and operating tasks are performed. It can be functional or divisional.

Span of management is the number of subordinates under a superior.

Functional structure groups activities on the basis of functions. The advantages of such a structure are specialisation, better control, managerial efficiency and ease in training employees. The disadvantages are functional empires, conflict of interest, inflexibility, and restriction in managerial development.

Divisional structure groups activities on the basis of products. The advantages are integration, product specialisation, greater accountability, flexibility, better coordination and more initiative. The disadvantages are departmental conflicts, costly process, ignoring of organisational interests, increase in requirements of general managers.

Formal organisation is designed by the management to achieve organisational goals. Its advantages are fixation of responsibility, clarity of roles, unity of command and effective accomplishment of goals. Its disadvantages are procedural delays, inadequate recognition of creativity, limited in scope.

Informal organisation arises out of interaction amongst people at work. Its advantages are speed, fulfillment of social needs, fills inadequacies of formal structure. Its disadvantages are: disruptive force, resistance to change and priority to group interests.

Delegation is the transfer of authority from superior to subordinate. It has three elements: Authority, Responsibility and Accountability.

Importance of delegation is that it helps in effective management, employee development, motivation, growth and coordination

Decentralisation is delegation of authority throughout the organisation.

Importance of decentralisation is that it helps in development of managerial talent, quick decision making reducing burden on top management, development of initiative, growth and better control.

Exercises

Multiple Choice

1. Which of the following is not an element of delegation?
   (a) Accountability
   (b) Authority
   (c) Responsibility
   (d) Informal organisation
2. A network of social relationship that arise spontaneously due to interaction at work is called:
   (a) Formal organisation
   (b) Informal organisation
   (c) Decentralisation
   (d) Delegation
3. Which of the following does not follow the scalar chain?
   (a) Functional structure
   (b) Divisional structure
   (c) Formal organisation
   (d) Informal organisation.
4. A tall structure has a
   (a) Narrow span of management
   (b) Wide span of management
   (c) No span of management
   (d) Less levels of management
5. Centralisation refers to
   (a) Retention of decision making authority
   (b) Dispersal of decision making authority
   (c) Creating divisions as profit centers
   (d) Opening new centers or branches
6. For delegation to be effective it is essential that responsibility be accompanied with necessary
   (a) Authority
   (b) Manpower
   (c) Incentives
   (d) Promotions
7. Span of management refers to
   (a) Number of managers
   (b) Length of term for which a manager is appointed

(c) Number of subordinates under a superior
(d) Number of members in top management

8. The form of organisation known for giving rise to rumors is called
   (a) Centralised organisation
   (b) Decentralised organisation
   (c) Informal organisation
   (d) Formal organisation
9. Grouping of activities on the basis of product lines is a part of
   (a) Delegated organisation
   (b) Divisional organisation
   (c) Functional organisation
   (d) Autonomous organisation
10. Grouping of activities on the basis of functions is a part of
   (a) Decentralised organisation
   (b) Divisional organisation
   (c) Functional organisation
   (d) Centralised organisation

Short Answer Type

1. Define 'Organising'?
2. What are the steps in the process of organising?
3. Discuss the elements of delegation.
4. What does the term 'Span of management' refer to?
5. Under what circumstances would functional structure prove to be an appropriate choice?
6. Draw a diagram depicting a divisional structure.
7. Can a large sized organisation be totally centralised of decentralised? Give your opinion.
8. Decentralisation is extending delegation to the lowest level. Comment.

Long Answer Type

1. Why is delegation considered essential for effective organising?
2. What is a divisional structure? Discuss its advantages and limitations
3. Decentralisation is an optional policy. Explain why an organisation would choose to be decentralised.
4. How does informal organisation support the formal organisation?
5. Distinguish between centralisation and decentralisation.

6. How is a functional structure different from a divisional structure?

Application Type

1. Neha runs a factory wherein she manufactures shoes. The business has been doing well and she intends to expand by diversifying into leather bags as well as western formal wear thereby making her company a complete provider of corporate wear. This will enable her to market her business unit as the one stop for working women. Which type of structure would you recommend for her expanded organisation and why?
2. The production manager asked the foreman to achieve a target production of 200 units per day, but he doesn't give him the authority to requisition tools and materials from the stores department. Can the production manager blame the foreman if he is not able to achieve the desired target? Give reasons.
3. A manager enhances the production target from 500 units to 700 units per month but the authority to draw raw material was not given by him. The production manager could not achieve the revised production target. Who is responsible and which principle was violated?
4. A company has its registered office in Delhi, manufacturing unit at Gurgaon and marketing and sales department at Faridabad. The company manufactures the consumer products. Which type of organisational structure should it adopt to achieve its target?

Case Problem

1. A company, which manufactures a popular brand of toys, has been enjoying good market reputation. It has a functional organisational structure with separate departments for Production, Marketing, Finance, Human Resources and Research and Development.

   Lately to use its brand name and also to cash on to new business opportunities it is thinking to diversify into manufacture of new range of electronic toys for which a new market is emerging.

   Questions

   Prepare a report regarding organisation structure giving concrete reasons with regard to benefits the company will derive from the steps it should take.

2. A company manufacturing sewing machines set up in 1945 by the British promoters follows formal organisation culture in totality. It is facing lot of problems in delays in decision-making. As the result it is not able to adapt to changing business environment. The work force is also not motivated since they cannot vent their grievances except through formal channels, which involve red tape. Employee turnover is high. Its market share is also declining due to changed circumstances and business environment.

   Questions

   You are to advise the company with regard to change it should bring about in its organisation structure to overcome the problems faced by it. Give reasons in terms of benefits it will derive from the changes suggested by you. In which sectors can the company diversify keeping in mind the declining market for the product the company is manufacturing?

3. A company X limited manufacturing cosmetics, which has enjoyed a pre-eminent position in business, has grown in size. Its business was very good till 1991. But after that, new liberalised environment has seen entry of many MNC's in the sector.

   With the result the market share of X limited has declined. The company had followed a very centralised business model with Directors and divisional heads making even minor decisions. Before 1991 this business model had served the company very well as consumers had no choice. But now the company is under pressure to reform.

   Questions

   What organisation structure changes should the company bring about in order to retain its market share?

   How will the changes suggested by you help the firm? Keep in mind that the sector in which the company is FMCG.

6

CHAPTER

STAFFING

Management of Human Resources at INFOSYS

"Our assets walk out of the door each evening. We have to make sure that they come back the next morning" (Narayana Murthy, CEO, Infosys).

At a time when organisations are debating the strategic importance of their human resources, Infosys, a consulting and software services organisation, includes its human resources on its balance sheet to affirm their asset value. The rationale for this is as follows: "The long term success of a company is usually examined on certain financial and non-financial parameters. Human resources are among these new non-financial parameters that challenge the usefulness of evaluating corporate success solely on traditional measures. Human resources represent the collective expertise, innovation, leadership, entrepreneurial and managerial skills endowed in the employees of an organisation."

As a knowledge intensive company, Infosys recognises the value of its human assets in maintaining its competitive position. It realises that these assets can easily walk away, as competitors in India and abroad covet its IT talent. Consequently, the challenge facing Infosys is how to attract, retain and develop its human assets in a highly competitive and dynamic environment?

Most of the current human resource practices at Infosys result from the vision of the leaders and the culture that they have created. Narayana Murthy, known for his leadership and vision is the public image of Infosys. His leadership style is humble and straight-forward, quite uncommon in the world of Indian business. He believes in sharing wealth with his employees and in leading by example. In a knowledge-based business like Infosys, he sees the importance of consistency in rhetoric and action in empowering employees. He is credited with creating a culture of closeness and empowerment at Infosys. His management style, rare among Indian business leaders, is based on western management.

Source: Sumita Raghuram, Fordham Graduate School of Business

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- define staffing;
- establish its relationship with Human Resource Management;
- state the need and importance of staffing;
- describe the steps in the staffing process;
- state the meaning of recruitment and selection;
- identify important sources of recruitment;
- describe the steps in the selection process;
- appreciate the need of training and development; and
- explain various on the job and off the job methods of training.

Introduction

The foundation of any organisation is the talented and hardworking people, who are the principal assets of any firm. It is an established fact that the growth of an organisation requires the continual infusion of quality staff. Thus, adequate staffing or the provision for appropriate human resources is an essential requirement for any organisation's success. It is, therefore, believed that an organisation can achieve its objectives only when it has the right persons in the right positions.

Meaning

After planning and selection of the organisation structure, the next step in the management process is to fill the various posts provided in the organisation. This is termed as the management of staffing function. In the simplest terms, staffing is 'putting people to jobs'. It begins with workforce planning and includes different other function like recruitment, selection, training, development, promotion, compensation and performance appraisal of work force. In other words, staffing is that part of the process of management which is concerned with obtaining, utilising and maintaining a satisfactory and satisfied work force. Today, staffing may involve any combination of employees including daily wagers, consultants and contract employees. Staffing recognises the importance of every single person employed by an organisation as it is the individual worker, who is the ultimate performer.

Staffing has been described as the managerial function of filling and keeping filled the positions in the organisation structure. This is achieved by, first of all, identifying requirement of work force, followed by recruitment, selection, placement, promotion, appraisal and development of personnel, to fill the roles designed into the organisation structure.

In a new enterprise, the staffing function follows the planning and organising functions. After deciding what is to be done, how it is to be done and after creation of the organisation structure, the management is in a position to know the human resource requirements of the enterprise at different levels. Once the number and types of personnel to be selected is determined, management starts with the activities relating to recruiting, selecting and training people, to fulfill the requirements of the enterprise. In an existing enterprise, staffing is a continuous process because new jobs may be created and some of the existing employees may leave the organisation.

Importance of Staffing

In any organisation, there is a need for people to perform work. The staffing function of management fulfills this requirement and finds the right people for the right job. Basically, staffing fills the positions as shown in the organisation structure.

Human resources are the foundation of any business. The right people can help you take your business to the top; the wrong people can break your business. Hence, staffing is the most fundamental and critical drive of organisational performance. The staffing function has assumed greater importance these days because of rapid advancement of technology, increasing size of organisation and complicated behaviour of human beings. Human resources are the most important asset of an organisation. The ability of an organisation to achieve its goal depends upon the quality of its human resources. Therefore, staffing is a very important managerial function. No organisation can be successful unless it can fill and keep filled the various positions provided for in the structure with the right kind of people.

Proper staffing ensures the following benefits to the organisation:

(i) helps in discovering and obtaining competent personnel for various jobs;

(ii) makes for higher performance, by putting right person on the right job;

(iii) ensures the continuous survival and growth of the enterprise through the succession planning for managers;

(iv) helps to ensure optimum utilisation of the human resources. By avoiding overmanning, it prevents under-utilisation of personnel and high labour costs. At the same time it avoids disruption of work by indicating in advance the shortages of personnel; and

(v) improves job satisfaction and morale of employees through objective assessment and fair reward for their contribution.

Staffing function must be performed efficiently by all organisations. If right kind of employees are not available, it will lead to wastage of materials, time, effort and energy, resulting in lower productivity and poor quality of products. The enterprise will not be able to sell its products profitably. It is, therefore, essential that right kind of people must be available in right number at the right time. They should be given adequate training so that wastage is minimum. They must also be induced to show higher productivity and quality by offering them proper incentives.

Staffing as part of Human Resource Management

It is a function which all managers need to perform. It is a separate and specialised function and there are many aspects of human relations to be considered. It is the job of managers to fill positions in their organisation and to make sure that they remain occupied with qualified people. Staffing is closely linked to organising since after the structure and positions have been decided, people are required to work in these positions. Subsequently, they need to be trained and motivated to work in harmony with the goals of the organisation. Thus, staffing is seen as a generic function of management.

The staffing function deals with the human element of management. Managing the human component of an organisation is the most important task because the performance of an organisation depends upon how well this function is performed. The success of an organisation in achieving its goals is determined to a great extent on the competence, motivation and performance of its human resource.

It is the responsibility of all managers to directly deal with and select people to work for the organisation. When the manager performs the staffing function his role is slightly limited. Some of these responsibilities will include placing the right person on the right job, introducing new employees to the organisation, training employees and improving their performance, developing their abilities, maintaining their morale and protecting their health and physical conditions. In small organisations, managers may perform all duties related to employees salaries, welfare and working conditions.

But as organisations grow and number of persons employed increases, a separate department called the human resource department is formed which has specialists in managing people. The management of human resource is a specialised area which requires the expertise of many people. The number of human resource specialists and size of this department gives an indication of the size of the business as well. For a very large company, the Human Resources Department itself will contain specialists for each function of this department.

Human Resource Management includes many specialised activities and duties which the human resource personnel must perform. These duties are:

- Recruitment i.e., search for qualified people
- Analysing jobs, collecting information about jobs to prepare job descriptions.
- Developing compensation and incentive plans.
- Training and development of employees for efficient performance and career growth.
- Maintaining labour relations and union management relations.
- Handling grievances and complaints.
- Providing for social security and welfare of employees.
- Defending the company in law suits and avoiding legal complications.

Evolution of Human Resource Management

Human resource management has replaced the traditional concept of labour welfare and personnel management. Human Resource Management (HRM) in its present form has evolved from a number of significant inter-related developments, which date back to the era of industrial revolution. Emergence of trade union movement led to the need of a person who could act as an effective link between the owners and workers. Thus, the concept of labour welfare officer came into being. His role was limited to the bare minimum welfare activities of employees. In fact, he was looked down by both the workers and the owners.

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

Human relations approach recognises human factor as the most imprtant instrument of success in an organisation. Fast changing technological developments, however, necessitated new skill development and training of employees. People came to be recognised as a valuable resource, which can be further developed. Increase in scope of the work led to replacement of personnel manager with human resource manager.

You may have observed that all these aspects are concerned with the human element in industry as distinct from the mechanical side of the enterprise. Thus, staffing is an inherent part of human resource management as it is the practice of finding, evaluating and establishing a working relationship with people, for a purpose.

It is important to understand that staffing is both a function of management just like planning, organising, directing, and controlling as well as a distinct functional area of management just as marketing management and financial management. Staffing, is therefore, referred to as both a line as well as a staff activity i.e., an essential function of the manager as well as an advisory role played by the Human Resource Department.

Staffing Process

As you are now aware, the prime concern of the staffing function in the management process is the timely fulfillment of the manpower requirements within an organisation. These requirements may arise in case of starting a new business or expanding the existing one or they may arise as a matter of the need for replacing those who quit, retire or are transferred or promoted from or are fired from the job. In any case, need for 'the right person for the right job' hardly needs an over emphasis. But just as the phrase 'water water everywhere and not a drop to drink' amplifies the fact that despite 2/3rd of the earth being water, drinkable water is a scarce commodity, so may also be said of finding 'the right person for the right job.' As such, it is important to appreciate staffing as a process that starts from understanding the manpower requirements within the organisation and identifying the potential sources from where it can be met, either from within the organisation or from outside. And, given that 'the right person' is scarce, there is need to 'market' the job and the organisation to the people. Even in situations where a single job vacancy might attract a few hundreds of the applicants, there is a challenge of selecting the most appropriate one. Freshly appointed persons might need orientation or training to familiarise them with the way the things are done in an organisation. And, in case they have been selected only on the basis of academic qualifications and aptitude for learning, they might need training in specific skills as well. For example, if one is selected by a Business Process Outsourcing (BPO) unit by virtue of being extrovert and well-versed in English speaking, one needs to be trained in the relevant business processes, telephone conversation etiquettes as well as diction adaptation before actual placement. The employee's experiences during orientation and placement form his/her 'first impression' of the organisation. Even whilst on the job, the employees need training for upgradation of knowledge and skills and for preparing for higher responsibilities. So staff training and development is another important aspect of the staffing process.

What follows is a brief description of the above stages.

(i) **Estimating the Manpower Requirements:** You are aware that while designing the organisational structure, we undertake an analysis of the decisions and the decision-making levels, activities as well as relationship among them with a view to evolving the horizontal and vertical dimensions of the structure. Thus, various job positions are created. Clearly, performance of each job necessitates the appointment of a person with a specific set of educational qualifications, skills, prior experience and so on.

Thus, understanding manpower requirements is not merely a matter of knowing how many persons we need but also of what type. Given that we need to encourage women, persons from backward communities and persons with special abilities (such as physically challenged, visually and hearing impaired) to assume responsible positions in our organisations, there is a need to understand, and if the need be, to redefine manpower requirements accordingly. Can you think why should we encourage such a diversity in the workforce?

Operationally, understanding the manpower requirements would necessitate workload analysis on the one hand and workforce analysis on the other. Workload analysis would enable an assessment of the number and types of human resources necessary for the performance of various jobs and accomplishment of organisational objectives. Workforce analysis would reveal the number and type available. In fact such an exercise would reveal whether we are understaffed, overstaffed or optimally staffed. It may be pointed out that neither over-staffing nor under-staffing is a desirable situation. Can you think why? In fact this exercise would form the basis of the subsequent staffing actions. A situation of overstaffing somewhere would necessitate employee removal or transfer elsewhere. A situation of understaffing would necessitate the starting of the recruitment process. However, before that can be done, it is important to translate the manpower requirements into specific job description and the desirable profile of its occupant — the desired qualifications, experience, personality characteristics and so on. This information becomes the base for looking for potential employees.

(ii) **Recruitment:** Recruitment may be defined as the process of searching for prospective employees and stimulating them to apply for jobs in the organisation. The information generated in the process of writing the job description and the candidate profile may be used for developing the 'situations vacant' advertisement. The advertisement may be displayed on the factory/ office gate or else it may be got published in print media or flashed in electronic media. This step involves locating the potential candidate or determining the sources of potential candidates. In fact, there are a large number of recruitment avenues available to a firm which would be discussed latter when we talk about the various sources of recruitment. The essential objective is to create a pool of the prospective job candidates. Both internal and external sources of recruitment may be explored. Internal sources may be used to a limited extent. For fresh talent and wider choice external sources are used.

(iii) **Selection:** Selection is the process of choosing from among the pool of the prospective job candidates developed at the stage of recruitment. Even in case of highly specialised jobs where the choice space is very narrow, the rigour of the selection process serves two important purposes: (i) it ensures that the organisation gets the best among the available, and (ii) it enhances the self-esteem and prestige of those selected and conveys to them the seriousness with which the things are done in the organisation. The rigour involves a host of tests and interviews, described later. Those who are able to successfully negotiate the test and the interviews are offered an employment contract, a written document containing the offer of employment, the terms and conditions and the date of joining.

(iv) **Placement and Orientation:** Joining a job marks the beginning of socialisation of the employee at the workplace. The employee is given a brief presentation about the company and is introduced to his superiors, subordinates and the colleagues. He is taken around the workplace and given the charge of the job for which he has been selected. This process of familiarisation is very crucial and may have a lasting impact on his decision to stay and on his job performance. Orientation is, thus, introducing the selected employee to other employees and familiarising him with the rules and policies of the organisation. Placement refers to the employee

Over-staffing: More play, less work

occupying the position or post for which the person has been selected.

(v) **Training and Development:** What people seek is not simply a job but a career. Every one must have the opportunity to rise to the top. The best way to provide such an opportunity is to facilitate employee learning. Organisations have either in-house training centers or have forged alliances with training and educational institutes to ensure continuing learning of their employees. The organisations too benefit in turn. If employee motivation is high, their competencies are strengthened, they perform better and thus, contribute more to organisational effectiveness and efficiency. By offering the opportunities for career advancement to their members, organisations are not only able to attract but also retain its talented people.

As discussed earlier, in most organisations there is a separate Human Resource Department, which takes care of the staffing function. But in small organisations the line manager is required to perform all the functions of management viz, planning, organising, staffing, directing and controlling. The process of staffing will then include three more stages.

(vi) **Performance Appraisal**

After the employees have undergone a period of training and they have been on the job for some time, there is a need to evaluate their performance. All organisations have some formal or informal means of appraising their employee's performance. Performance appraisal means evaluating an employee's current and/or past performance as against certain predetermined standards. The employee is expected to know what the standards are and the superior is to provide the employee feedback on his/her performance. The performance appraisal process, therefore, will include defining the job, appraising performance and providing feedback

(vii) **Promotion and career planning**

It becomes necessary for all organisations to address career related issues and promotional avenues for their employees. Managers need to design activities to serve employees' long-term interests also. They must encourage employees to grow and realise their full potential. Promotions are an integral part of people's career. They refer to being placed in positions of increased responsibility. They usually

Managers in Business Process Outsourcing (BPO) Units

The BPO manager has more often than not been projected as a person who presides over hundreds of young professionals, with head-phones and attitudes, and whose biggest challenge is to keep his young wards from joining the competition.

A new industry, no experience, a young work force, stringent service-level agreements- the list is endless. Understanding these equally important facets to the BPO manager's job will help reveal that the operation head's is one of the most challenging jobs.

A BPO is often seen as a job and not a career – a mere stop-gap arrangement and stepping stone for those hoping to get an early start. But the BPO industry offers a challenging environment for growth and provides ample opportunities, not only at junior positions but for middle to senior-level executives to work in global teams and gain international and industry specific exposure. Playing a pivotal role in the BPO environment, a manager is the critical link between the customer and the delivery team. Putting the client's business first is the starting rule to success.

Most BPO managers in the industry hail from fields like telecom, insurance, banking, hospitality, retail and manufacturing. The challenge lies in extracting best practices from these diverse disciplines and crafting a unique system that is best suited to the needs of the outsourcing industry. This calls upon learning the intricacies of the job 'on the job'. Although BPO companies impart comprehensive training at the entry level, managers have to use their professional experiences and translate those learnings into the BPO environment.

Source: The Economic Times, Nov. 06

mean more pay, responsibility and job satisfaction.

(viii) **Compensation**

All organisations need to establish wage and salary plans for their employees. There are various ways to prepare different pay plans depending on the worth of the job. Basically the price of the job needs to be determined. Compensation, therefore, refers to all forms of pay or rewards going to employees. It may be in the form of direct financial payments like wages, salaries, incentives, commissions and bonuses and indirect payments like employer paid insurance and vacations.

Direct financial payments are of two types : time based or performance based. A time based plan means salary and wages are paid either daily, weekly or monthly or annually. Performance based plans means salary/wages are paid according to piecework. For example, a worker may be paid according to the number of units produced by him/her. There are many methods to calculate the compensation under various incentive plans to reward performance. Certain pay plans can be created which are a combination of time based pay plus incentives for higher performance. Various plans may be formulated for paying employees time based wage or salary as well as performance based financial incentives and bonuses, and employee benefits.

Besides there are some other factors also which influence the design of any pay plan, like legal (labour laws), union, company policy and equity.

Thus, we see that as a process, staffing includes acquisition, retention, development, performance appraisal, promotion and compensation of the most important resource of an organisation, that is, its human capital.

It needs to be kept in mind that several factors such as supply and demand of specific skills in the labour market, unemployment rate, labour market conditions, legal and political considerations, company's image, policy, human resource planning cost, technological developments and general economic environment etc., will influence the way recruitment, selection and training will be actually carried out.

RECRUITMENT

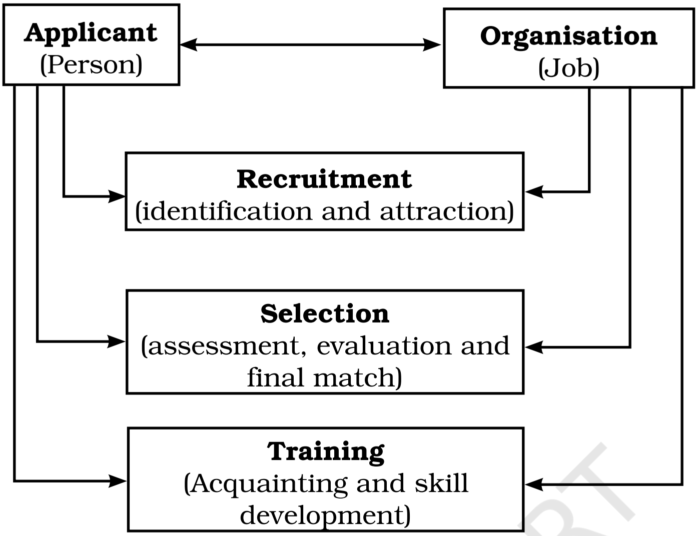
Recruitment refers to the process of finding possible candidates for a job or a function. It has been defined as 'the process of searching for prospective employees and stimulating them to apply for jobs in an organisation.'

Advertising is commonly part of the recruitment process, and can occur through several means, through newspapers, using newspaper dedicated to job advertisement, through professional publication, using advertisements placed in windows, through a job center, through campus interviews, etc.

Sources of Recruitment

The object of recruitment is to attract potential employees with the necessary characteristics or qualification, in the adequate number for the jobs available. It locates available people for the job and invites them to apply for the job in the organisation. The process of recruitment precedes the process of selection of a right candidate for the given positions in the organisation. Recruitment seeks to attract suitable applicants to apply for available jobs. The various activities involved with the process of recruitment includes (a) identification of the different sources of labour supply, (b) assessment of their validity, (c) choosing the most suitable source or sources, and (d) inviting applications from the prospective candidates, for the vacancies.

The requisite positions may be filled up from within the organisation



Aspects of Staffing

or from outside. Thus, there are two sources of recruitment – Internal and External.

Internal Sources

There are two important sources of internal recruitment, namely, transfers and promotions, which are discussed below:

(i) **Transfers:** It involves shifting of an employee from one job to another, one department to another or from one shift to another, without a substantive change in the responsibilities and status of the employee. It may lead to changes in duties and responsibilities, working condition etc., but not necessarily salary. Transfer is a good source of filling the vacancies with employees from over-staffed departments. It is practically a horizontal movement of employees. Shortage of suitable personnel in one branch may be filled through transfer from other branch or department. Job transfers are also helpful in avoiding termination and in removing individual problems and grievances. At the time of transfer, it should be ensured that the employee to be transferred to another job is capable of performing it. Transfers can also be used for training of employees for learning different jobs.

(ii) **Promotions:** Business enterprises generally follow the practice of filling higher jobs by promoting employees from lower jobs. Promotion leads to shifting an employee to a higher position, carrying higher responsibilities, facilities, status and pay. Promotion is a vertical shifting of employees. This practice helps to improve the motivation, loyalty and satisfaction level of employees. It has a great psychological impact over the employees because a promotion at the higher level may lead to a chain of promotions at lower levels in the organisation.

Merits of Internal Sources

Filling vacancies in higher jobs from within the organisation or through internal transfers has the following merits:

(i) Employees are motivated to improve their performance. A promotion at a higher level may lead to a chain of promotion at lower levels in the organisation. This motivates the employees to improve their performance through learning and practice. Employees work with commitment and loyalty and remain satisfied with their jobs. Also peace prevails in the enterprise because of promotional avenues;

(ii) Internal recruitment also simplifies the process of selection and placement. The candidates that are already working in the enterprise can be evaluated more accurately and economically. This is a more reliable way of recruitment since the candidates are already known to the organisation;

(iii) Transfer is a tool of training the employees to prepare them for higher jobs. Also people recruited from within the organisation do not need induction training;

(iv) Transfer has the benefit of shifting workforce from the surplus departments to those where there is shortage of staff;

(v) Filling of jobs internally is cheaper as compared to getting candidates from external sources.

Limitations of Internal Sources

The limitations of using internal sources of recruitment are as follows:

(i) When vacancies are filled through internal promotions, the scope for induction of fresh talent is reduced. Hence, complete reliance on internal recruitment involves danger of 'inbreeding' by stopping 'infusion of new blood' into the organisation;

(ii) The employees may become lethargic if they are sure of time-bound promotions;

(iii) A new enterprise cannot use internal sources of recruitment. No organisation can fill all its vacancies from internal sources;

(iv) The spirit of competition among the employees may be hampered; and

(v) Frequent transfers of employees may often reduce the productivity of the organisation.

External Sources

An enterprise has to tap external sources for various positions because all the vacancies cannot be filled through internal recruitment. The existing staff may be insufficient or they may not fulfill the eligibility criteria of the jobs to be filled.

External recruitment provides wide choice and brings new blood in the organisation. The commonly used external sources of recruitment are discussed below:

(i) **Direct Recruitment:** Under the direct recruitment, a notice is placed on the notice-board of the enterprise specifying the details of the jobs available. Job-seekers assemble outside the premises of the organisation on the specified date and selection is done on the spot. The practice of direct recruitment is followed usually for casual vacancies of unskilled or semi-skilled jobs. Such workers are known as casual or '*badli*' workers and they are paid remuneration on daily wage basis. This method of recruitment is very inexpensive as it does not involve any cost of advertising the vacancies. It is suitable for filling casual vacancies when there is a rush of work or when some permanent workers are absent.

(ii) **Casual Callers:** Many reputed business organisations keep a database of unsolicited applicants in their offices. Such job-seekers can be a valuable source of manpower. A list of such job-seekers can be prepared and can be screened to fill the vacancies as they arise. The major merit of this source of recruitment is that it reduces the cost of recruiting workforce in comparison to other sources.

(iii) **Advertisement:** Advertisement in newspapers or trade and professional journals is generally used when a wider choice is required. Most of the senior positions of industry as well as commerce are filled by this method. The advantage of advertising vacancies is that more information about the organisation and job can be given in the advertisement. Advertisement gives the management a wider range of candidates from which to choose. Advertisements may be placed in leading newspapers. Its disadvantage is that it may bring in a flood of response, and many times, from quite unsuitable candidates.

(iv) **Employment Exchange:** Employment exchanges run by the Government are regarded as a good source of recruitment for unskilled and skilled operative jobs. In some cases, compulsory notification of vacancies to employment exchange is required by law. Thus, employment exchanges help to match personnel demand and supply by serving as link between job-seekers and employers. Unfortunately, the records of employment exchange are often not uptodate and many of the candidates referred by them may not be found suitable.

(v) **Placement Agencies and Management Consultants:** In technical and professional areas, private agencies and professional bodies appear to be doing substantive work. Placement agencies provide a nationwide service in matching personnel demand and supply. These agencies compile bio-data of a large number of candidates and recommend suitable names to their clients. Such agencies charge fee for their services and they are useful where extensive screening is required. These professional recruiters can entice the needed top executives from other companies by making the right offers.

Management consultancy firms help the organisations to recruit technical, professional and managerial personnel. They specialise in middle level and top level executive placements. They maintain data bank of persons with different qualifications and skills and even advertise the jobs on behalf of their clients to recruit right type of personnel.

(vi) **Campus Recruitment:** Colleges and institutes of management and technology have become a popular source of recruitment for technical, professional and managerial jobs. Many big organisations maintain a close liaison with the universities, vocational schools and management institutes to recruit qualified personnel for various jobs. Recruitment from educational institutions is a well-established practice of businesses. This is referred to as campus recruitment.

(vii) **Recommendations of Employees:** Applicants introduced by present employees, or their friends and relatives may prove to be a good source of recruitment. Such applicants are likely to be good employees because their background is sufficiently known. A type of preliminary screening takes place because the present employees know both the company and the candidates and they would try to satisfy both.

(viii) **Labour Contractors:** Labour contractors maintain close contacts with labourers and they can provide the required number of unskilled workers at short notice. Workers are recruited through labour contractors who are themselves employees of the organisation. The disadvantages of this system are that if the contractor himself decides to leave the organisation, all the workers employed through him will follow suit.

(ix) **Advertising on Television:** The practice of telecasting of vacant posts over Television is gaining importance these days. The detailed requirements of the job and the qualities required to do it are publicised alongwith the profile of the organisation where vacancy exists.

(x) **Web Publishing:** Internet is becoming a common source of recruitment these days. There are certain websites specifically designed and dedicated for the purpose of providing information about both job seekers and job opening. In fact, websites such as www.naukri.com, www.jobstreet.com etc., are very commonly visited both by the prospective employees and the organisations searching for suitable people.

Campus Recruitment

Merits of External Sources

The advantages of using external sources of recruitment are as follows:

(i) *Qualified Personnel:* By using external sources of recruitment, the management can attract qualified and trained people to apply for vacant jobs in the organisation.

(ii) *Wider Choice:* When vacancies are advertised widely, a large number of applicants from outside the organisation apply. The management has a wider choice while selecting the people for employment.

(iii) *Fresh Talent:* The present employees may be insufficient or they may not fulfill the specifications of the jobs to be filled. External recruitment provide wider choice and brings new blood in the organisation. However, it is expensive and time-consuming.

(iv) *Competitive Spirit:* If a company taps external sources, the extisting staff will have to compete with the outsiders. They will work harder to show better performance.

Limitations of External Sources

1. *Dissatisfaction among existing staff:* External recruitment may lead to dissatisfaction and frustration among existing employees. They

may feel that their chances of promotion are reduced.

2. *Lengthy process:* Recruitment from external sources takes a long time. The business has to notify the vacancies and wait for applications to initiate the selection process.
3. *Costly process:* It is very costly to recruit staff from external sources. A lot of money has to be spent on advertisement and processing of applications.

Selection

Selection is the process of identifying and choosing the best person out of a number of prospective candidates for a job. Towards this purpose, the candidates are required to take a series of employment tests and interviews. At every stage many are eliminated and a few move on to the next stage until the right type is found. The process may start right from the screening of the applications. It may continue even after the offer of employment, acceptance and joining of the candidate. It is so because the process of selection, like any other managerial

IT Firms Depend upon Employee Referrals – Improves Retention Rate

Staffers across many IT companies have won themselves iPods or Asian holidays, motorbikes or even a Maruti Swift. Clearly, employee referrals or buddy recruitments are increasingly becoming big-ticket incentives with staffers enjoying freebies along with hefty bonuses.

On its part, the company not only gets the kind of talent it is eyeing, but also manages to cut recruitment cost considerably, notwithstanding the high payouts. Recruitments through a consultant would typically cost about 25% more. Referral incentives have risen by about 20% in the last two years. Companies have realised that they can bring down the recruitment cost by about 50% through this system.

At the $2.4 billion Juniper Networks, the referral system accounted for 50% of the 290 employees recruited this year.

Referral bonus helps encourage employees to bring like-minded people to the company. This, in turn, will improve retention rate, said Juniper India MD. Besides monetary benefit, 'successful recruiters' within Juniper also hold a chance to win gifts like motorbikes and flat screen TVs every quarter.

Referral system, corporates say, help minimise risks in a tight job market. Most companies allow employees to refer another person on the first day of the appointment itself in the form of a buddy list.

Besides lower costs, referrals help companies ensure the new recruit's sound credentials. Unlike an unknown resume, a referred person is considered to be more reliable as employees also tend to share a certain responsibility in this case.

Source: The Economic Times, 10th December 06 decision, involves judgment about the performance potential of the candidate. The effectiveness of the selection process would ultimately be tested in terms of on-the-job of the chosen person.

Process of Selection

The important steps in the process of selection are as follows:

(i) **Preliminary Screening:** Preliminary screening helps the manager eliminate unqualified or unfit job seekers based on the information supplied in the application forms. Preliminary interviews help reject misfits for reasons, which did not appear in the application forms.

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

Important Tests Used for Selection of Employees:

(a) *Intelligence Tests:* This is one of the important psychological tests used to measure the level of intelligence

Intense Competition, Talent Crunch Push Companies to Hand Out 15-20% Pay Hikes

Indian employees have never had it so good. Intense competition and rising attrition levels are forcing companies to hand out 15-20% mid-term salary hikes.

Reliance Industries, Marico and Dabur have offered mid-term increments and out-of-turn hikes of 15-20% to top performers in recent months. This is over and above the 15-20% salary hikes handed out during annual appraisals last year. This comes at a time when India Inc. is desperately trying to hold back talent, especially in telecom, IT, BPO and retail.

A massive recruitment spree in sunrise sectors like BPO, telecom and retail has led to a demand-supply mismatch and mid-term hikes going up to 40%. Average attrition rates in IT have moved up to 22% from 18% and those in BPOs to 50% from 46%. In the manufacturing sector, talent exodus is averaging 8-12%.

Several corporates are even offering bonuses and increments on a quarterly basis to top teams. An HR head said, "Although it is a short-term reaction, we have to react proactively to the market scenario and retain our performers. If one loses an employee, the average time taken for a new person to pick up the skills is up to six months, which is critical time lost for a company. Also, replacement costs like hiring consultants would in any case add up to a huge expense and a lot of pressure on HR," said Dabur India HR chief.

Company are identifying people who may be tempted to leave and are devising ways of retaining such talent – offering learning and development facilities for freshers, sending them abroad on one-year bonds (for six-months postings), etc.

Source: The Economic Times, 1st Dec. 06 quotient of an individual. It is an indicator of a person's learning ability or the ability to make decisions and judgments.

(b) *Aptitude Test:* It is a measure of individuals potential for learning new skills. It indicates the person's capacity to develop. Such tests are good indices of a person's future success score.

(c) *Personality Tests:* Personality tests provide clues to a person's emotions, her reactions, maturity and value system etc. These tests probe the overall personality. Hence, these are difficult to design and implement.

(d) *Trade Test:* These tests measure the existing skills of the individual. They measure the level of knowledge and proficiency in the area of professions or technical training. The difference between aptitude test and trade test is that the former measures the potential to acquire skills and the later the actual skills possessed.

(e) *Interest Tests:* Every individual has fascination for some job than the other. Interest tests are used to know the pattern of interests or involvement of a person.

(iii) **Employment Interview:** Interview is a formal, in-depth conversation conducted to evaluate the applicant's suitability for the job. The role of the interviewer is to seek information and that of the interviewee is to provide the same. Though, in present times, the interviewee also seeks information from interviewer.

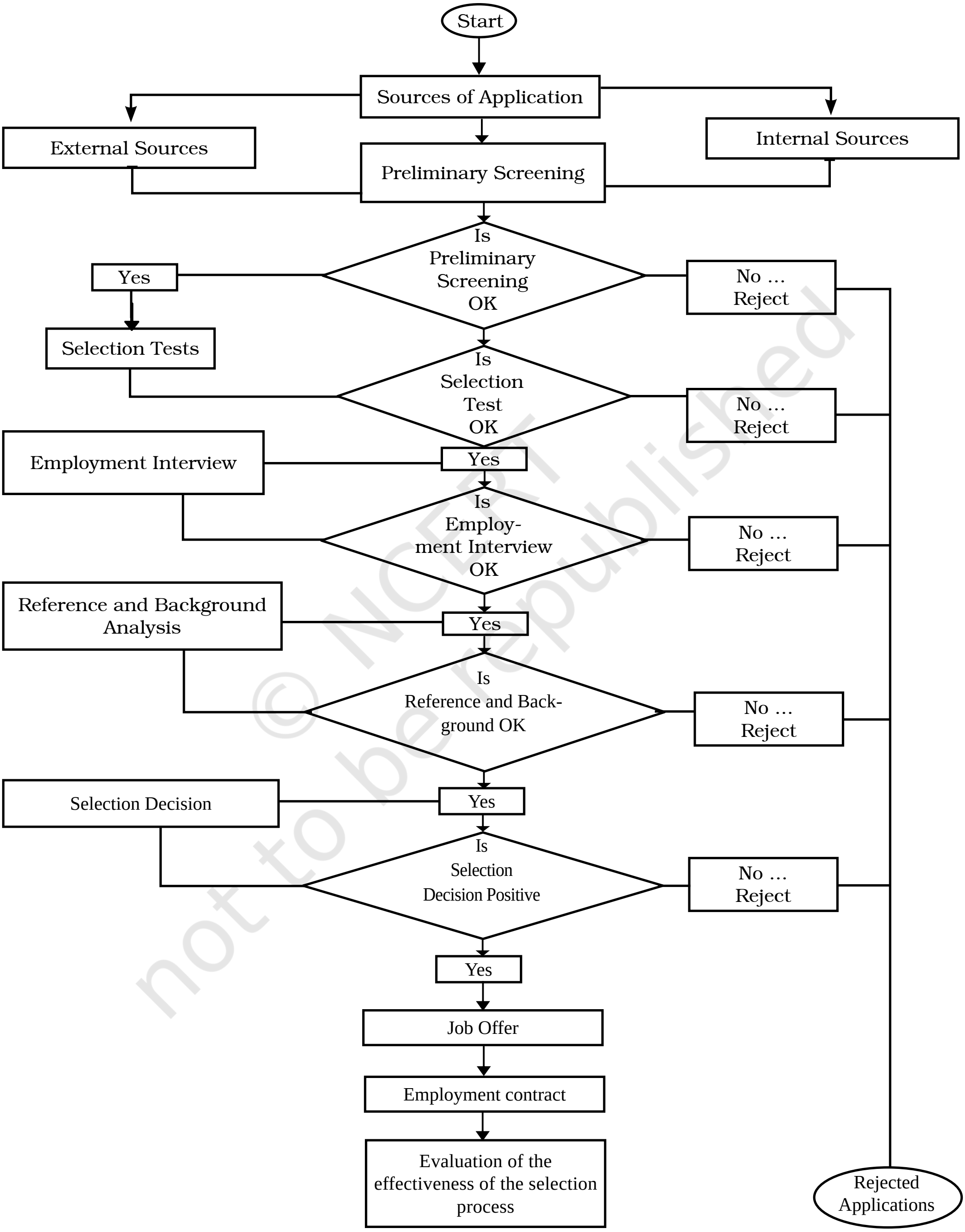
(iv) **Reference and Background Checks:** Many employers request names, addresses, and telephone numbers of references for the purpose of verifying information and, gaining additional information on an applicant. Previous employers, known persons, teachers and university professors can act as references.

Some Definitions

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

Selection is a managerial decision making process as to predict which job applicants will be successful if hired. *David and Robbins*

Selection is the process of differentiating between applicants in order to identify and hire those with a greater likelihood of success in a job. *Stone*



Start
Sources of Application
External Sources
Internal Sources
Preliminary Screening
Is Preliminary Screening OK
Yes
No ... Reject
Selection Tests
Is Selection Test OK
No ... Reject
Employment Interview
Yes
Is Employ-ment Interview OK
No ... Reject
Reference and Background Analysis
Yes
Is Reference and Back-ground OK
No ... Reject
Selection Decision
Yes
Is Selection Decision Positive
No ... Reject
Yes
Job Offer
Employment contract
Evaluation of the effectiveness of the selection process
Rejected Applications

(v) **Selection Decision:** The final decision has to be made from among the candidates who pass the tests, interviews and reference checks. The views of the concerned manager will be generally considered in the final selection because it is he/she who is responsible for the performance of the new employee.

(vi) **Medical Examination:** After the selection decision and before the job offer is made, the candidate is required to undergo a medical fitness test. The job offer is given to the candidate being declared fit after the medical examination.

(vii) **Job Offer:** The next step in the selection process is job offer to those applicants who have passed all the previous hurdles. Job offer is made through a letter of appointment/confirm his acceptance. Such a letter generally contains a date by which the appointee must report on duty. The appointee must be given reasonable time for reporting.

(viii) **Contract of Employment:** After the job offer has been made and candidate accepts the offer, certain documents need to be executed by the employer and the candidate. One such document is the attestation form. This form contains certain vital details about the candidate, which are authenticated and attested by him or her. Attestation form will be a valid record for future reference. There is also a need for preparing a contract of employment. Basic information that should be included in a written contract of employment will vary according to the level of the job, but the following checklists sets out the typical headings: Job Title, Duties, Responsibilities, Date when continuous employment starts and the basis for calculating service, rates of pay, allowances, hours of work, leave rules, sickness, grievance procedure,

Right/ Wrong Selection Decisions Matter a lot to the Organisations!

Consider, for a moment that any selection decision can result in 4 possible outcomes. A decision is correct when an applicant was predicted to be successful and proved to be successful on the job, or when the applicant was predicted to be unsuccessful and would perform accordingly if hired. In the first case, we have successfully accepted; in the second case we have successfully rejected. Problems arise when errors are made in rejecting candidates who would have performed successfully on the job (reject errors) or accepting those who ultimately perform poorly (accept errors). Don't you think, these problems can be significant and can result in costly mistakes?

disciplinary procedure, work rules, termination of employment.

Training and Development

Someone has rightly said:

"If you wish to plan for a year, sow seeds,

If you wish to plan for 10 years, plant trees,

If you wish to plan for a lifetime, develop people."

Training and Development is an attempt to improve the current or future employee performance by increasing an employee's ability to perform through learning, usually by changing the employee's attitude or increasing his or her skills and knowledge.

Importance of Training and Development

When jobs were simple, easy to learn and influenced to only a small degree by technological changes, there was little need for employees to upgrade or alter their skills. But the rapid changes taking place during the last quarter century in our highly sophisticated and complex society have created increased pressures for organisations to readapt the products and services produced, the manner in which products and services are produced and offered, the types of jobs required and the types of skills necessary to complete these jobs. Thus, as jobs have become more complex the importance of employee training has increased.

Training and development help both the organisation and the individual.

Benefits to the organisation

The benefits of training and development to an organisation are as follows:

(i) Training is a systematic learning, always better than hit and trial methods which lead to wastage of efforts and money.

(ii) It enhances employee productivity both in terms of quantity and quality, leading to higher profits.

(iii) Training equips the future manager who can take over in case of emergency.

(iv) Training increases employee morale and reduces absenteeism and employee turnover.

(v) It helps in obtaining effective response to fast changing environment – technological and economic.

Benefits to the Employee

The benefits of training and development activity to the employees are as follows:

(i) Improved skills and knowledge due to training lead to better career of the individual.

(ii) Increased performance by the individual help him to earn more.

(iii) Training makes the employee more efficient to handle machines. Thus, less prone to accidents.

(iv) Training increases the satisfaction and morale of employees.

Training, Development and Education

The term training is used to indicate the process by which attitudes, skills and abilities of employees to perform specific jobs are increased. But the term development means growth of individual in all respects. Training is short term process but development is an on going process. Also, development includes training.

It also needs to be understood that training, education and development are distinct terms although they overlap to some extent.

Training is any process by which the aptitudes, skills and abilities of employees to perform specific jobs are increased. It is a process of learning new skills and application of knowledge. It attempts to improve their performance on the current job or prepare them for any intended job.

Education is the process of increasing the knowledge and understanding of employees. It is the understanding and interpretation of knowledge. It does not provide definite answers, but rather develops a logical and rational mind that can determine relationships among pertinent variables and thereby understand a phenomenon. Education imparts qualities of mind and character and understanding of the basic principles and develop the capacities of analysis, synthesis and objectivity. Education is broader in scope than training. Training is tied to the goals of organisations more than to the goals of the individual.

Development refers to the learning opportunities designed to help employees grow. It covers not only those activities which improve job performance but also those which bring about growth of the personality, help individuals in the progress towards maturity and actualisation of their potential capacities so that they become not only good employees but better men and women.

The field of training and development concerned with improving deals with the design and delivery

Difference between Training and Development

Training	Development
It is a process of increasing knowledge and skills.	It is a process of learning and growth.
It is to enable the employee to do the job better.	It is to enable the overall growth of the employee.
It is a job oriented process.	It is a career oriented process.

of learning to improve performance within organisations. In some organisations the term Learning and Development is used instead of Training and Development in order to emphasise the importance of learning for the individual and the organisation. In other organisations, the term Human Resource Development is used.

Training Methods

There are various methods of training. These are broadly categorised into two groups: On-the-Job and Off-the-Job methods. On-the-Job methods refer to the methods that are applied to the workplace, while the employee is actually working. Off-the-Job methods are used away from the work place. The former means learning while doing, while the latter means learning before doing.

On the Job Methods

(i) **Apprenticeship Programmes:** Apprenticeship programmes put the trainee under the guidance of a master worker. These are designed to acquire

Training of Staff at NTBSC (Dabbawalas)

Dressed in traditional kurta-payjama and a Gandhi topi, these two swayed HR managers from across the country.

While the presentations made by HR managers from reputed companies on developing human potential; HR perspective at Ahmedabad Management Association were well-received, it were Dabbawalas from Nutan Mumbai Tiffin Box Supply Charity (NTBSC) Trust who stole the show. Both Gangaram Talekar and Raghunath Medge made power-point presentations from their laptops.

From supply-chain management to organisation structure, each slide on the screen gave audience an insight into how NTBSC has successfully run their organisation for over 115 years.

This with error rate of just one in 16 million, six sigma of 99.9999%, without any technology back-up, standard pricing and no strikes. Above all, they also spoke about the zero attrition rate at NTBSC. Of the 5,000 people associated with the service, over 3,500 are illiterate. We don't even known what six sigma means, but we believe in customer satisfaction, he added. The duo touched upon time management, customer care, value-system of the organisation and training.

"Our experienced members teach trainees. For them it is very important to understand the code, as most of the new people who come to us are illiterate. We conduct a training programme for them. That's the reason why we have been able to maintain such a low error rate," said Medge.

Source: The Economic Times, 15th Nov. 06 a higher level of skill. People seeking to enter skilled jobs, to become, for example, plumbers, electricians or iron-workers, are often required to undergo apprenticeship training. These apprentices are trainees who spend a prescribed amount of time working with an experienced guide, or trainer. A uniform period of training is offered to trainees, in which both fast and slow learn here, are placed together. Slow learners may require additional training.

(ii) **Coaching:** In this method, the superior guides and instructs the trainee as a coach. The coach or counselor sets mutually agreed upon goals, suggests how to achieve these goals, periodically reviews the trainees progress and suggests changes required in behavior and performance. The trainee works directly with a senior manager and the manager takes full responsibility for the trainee's coaching. Classically the trainee is being groomed to replace the senior manager and relieve him from some of his duties. This gives a chance for the trainee to learn the job also.

(iii) **Internship Training:** It is a joint programme of training in which educational institutions and business firms cooperate. Selected candidates carry on regular studies for the prescribed period. They also work in some factory or office to acquire practical knowledge and skills.

(iv) **Job Rotation:** This kind of training involves shifting the trainee from one department to another or from one job to another. This enables the trainee to gain a broader understanding of all parts of the business and how the organisation as a whole functions. The trainee gets fully involved in the departments operations and also gets a chance to test her own aptitude and ability. Job rotation allows trainees to interact with other employees facilitating future cooperation among departments. When employees are trained by this method, the organisation finds it easier at the time of promotions, replacements or transfers.

Off the Job Methods

(i) **Class Room Lectures/Conferences:** The lecture or conference approach is well adapted to conveying specific information-rules, procedures or methods. The use of audio-visuals or demonstrations can often make a formal classroom presentation more interesting while increasing retention and offering a vehicle for clarifying more difficult points.

(ii) **Films:** They can provide information and explicitly demonstrate skills that are not easily represented by the other techniques. Used in conjunction with conference discussions, it is a very effective method in certain cases.

(iii) **Case Study:** Taken from actual experiences of organisations, cases represent attempts to describe, as accurately as possible real problems that managers have faced. Trainees study the cases to determine problems, analyse causes, develop alternative solutions, select what they believe to be the best solution, and implement it.

(iv) **Computer Modelling:** It simulates the work environment by programming a computer to imitate some of the realities of the job and allows learning to take place without the risk or high costs that would be incurred if a mistake were made in real life situation.

(v) **Vestibule Training:** Employees learn their jobs on the equipment they will be using, but the training is conducted away from the actual work floor. Actual work environments are created in a class room and employees use the same materials, files and equipment. This is usually done when employees are required to handle sophisticated machinery and equipment.

(vi) **Programmed Instruction:** This method incorporates a prearranged and proposed acquisition of some specific skills or general knowledge. Information is broken into meaningful units and these units are arranged in a proper way to form a logical and sequential learning package i.e. from simple to complex. The trainee goes through these units by answering questions or filling the blanks.

Key Terms

Staffing | Personnel Management

Human Resource Management

Recruitment | Selection

Training | Development

Performance Appraisal | Assessment Tests

Summary

Meaning: Staffing has been described as the managerial function of filling and keeping filled, the positions in an organisation structure. This is achieved by, first of all, identifying requirement of work force, followed by recruitment, selection, placement, promotion, appraisal and development of personnel, to fill the roles designed into the organisation structure.

Need and Importance of Staffing: In any organisation, there is a need for people to perform work. The staffing function of management fulfills this requirement and finds the right people for the right job.

The staffing function has assumed greater importance these days because of rapid advancement of technology, increasing size of organisation and complicated behaviour of human beings. The ability of an organisation to achieve its goal depends upon the quality of its human resources.

Staffing as part of Human Resource Management: Staffing is a function which all managers need to perform. It is a separate and specialised function and there are many aspects of human relations to be considered.

It is the responsibility of all managers to directly deal and select people to work for the organisation. When the manager performs the staffing function his role is slightly limited. In small organisations, managers may perform all duties related to employees salaries, welfare and working conditions.

But as organisations grow and number of persons employed increases, a separate department called the human resource department is formed which has specialists in the field to manage people.

Human Resource Management includes many specialised activities and duties which the human resource personnel must perform.

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

You may have observed that all these aspects are concerned with the human element in the industry as distinct from the mechanical side of the enterprise. Thus, staffing is an inherent part of human resource management as it is the practice of finding, evaluating and establishing a working relationship with people, for a purpose.

Staffing Process: The prime concern of the staffing function in the management process is the timely fulfillment of the manpower requirements within an organisation.

Estimating the Manpower Requirements: Performance of each job necessitates the appointment of a person with a specific set of educational qualifications, skills, prior experience and so on. Operationally, understanding the manpower requirements would necessitate workload analysis on the one hand and workforce analysis on the other.

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

Selection: Selection is the process of choosing from among the pool of the prospective job candidates developed at the stage of recruitment.

Placement and Orientation: Orientation is introducing the selected employee to other employees and familiarising him with the rules and policies of the organisation. Placement refers to the employee occupying the position or post for which the person has been selected.

Training and Development: What people seek is not simply a job but a career. Every one must have the opportunity to rise to the top. The best way to provide such an opportunity is to facilitate employee learning.

Recruitment

Recruitment refers to the process of finding possible candidates for a job or function.

Sources of Recruitment: The requisite positions may be filled up from within the organisation or from outside. Thus, there are two sources of recruitment – Internal and External.

Internal Sources: Recruitment from within the enterprise. There are two important sources of internal recruitment, namely, transfers and promotions.

External Sources: An enterprise has to tap external sources for various positions because all the vacancies cannot be filled through internal recruitment. The commonly used external sources of recruitment are Direct Recruitment, Casual Callers, Advertisements, Employment Exchange, Placement Agencies and Management Consultants, Campus Recruitment, Recommendations of Employees, Labour Contractors, Advertising on Television and Web Publishing.

Process of Selection: (i) Preliminary Screening: Application Form (ii) Selection Tests: (a) Intelligence Tests (b) Aptitude Test (c) Personality Tests (d) Trade Test (e) Interest Tests

(iii) Employment (iv) Interview, (v) Reference and Background Checks, (vi) Selection Decision, (vii) Medical Examination, (viii) Job Offer (ix) Contract of Employment

Training and Development

Need of Training and Development

The rapid changes taking place in our highly sophisticated and complex society have created increased pressures for organisations to readapt the products and services produced, the manner in which products and services are produced and offered, the types of jobs required and the types of skills necessary to complete these jobs.

Training is any process by which the aptitudes, skills and abilities of employees to perform specific jobs are increased.

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Training Methods

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On the Job Methods

(i) Apprenticeship Programs (ii) Coaching (iii) Internship Training (iv) Job Rotation

Off the Job Methods

Exercises

(i) Class Room Lectures/Conferences (ii) Films (iii) Case Study (iv) Computer Modelling (v) Vestibule Training (vi) Programmed Instruction.

Short Answer Type

1. Briefly enumerate the important sources of recruitment.
2. What is meant by recruitment? How is it different from selection?
3. Define Training. How is it different from education?
4. Distinguish between training and development.
5. Why are internal sources of recruitment considered to be more economical?
6. What is the importance of staffing function in today's environment?

Long Answer Type

1. Define the staffing process and the various steps involved in it?
2. Explain the procedure for selection of employees.
3. What are the advantages of training to the individual and to the organisation?
4. The staffing function is performed by every manager and not necessarily by a separate department. Explain.

Application Type

1. The workers of a factory are unable to work on new machines and always demand for help of supervisor. The Supervisor is overburdened with their frequent calls. Suggest the remedy.
2. The workers of a factory remain idle because of lack of knowledge of hi-tech machines. Frequent visit of engineer is made which causes high overhead charges. How can this problem be removed.
3. The quality of Production is not as per standards. On investigation it was observed that most of the workers were not fully aware of the proper operation of the machinery. What could be the way to improve the accuracy?
4. An organisation provides security services. It requires such candidates who are reliable and don't leak out the secrets of their clients. What step should be incorporated in selection process?
5. A company is manufacturing paper plates and bowls. It produces 100000 plates and bowls each day. Due to local

Case Study

festival, it got an urgent order of extra 50,000 plates bowls. Advise how the company will fulfill its order and which method of recruitment would you suggest.

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

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

Questions

1. Outline the process of staffing the company should follow.
2. Which sources of recruitment the company should rely upon. Give reasons for your recommendation.
3. Outline the process of selection the company should follow with reasons.
4. Which methods of training and development should be company initiate? Explain giving reasons.

(ii) A major insurance company handled all recruiting, screening and training processes for data entry/customer service representatives. Their competitor was attracting most of the qualified, potential employees in their market. Recruiting was made even more difficult by the strong economy and the 'job-seeker's market.' This resulted in the client having to choose from candidates who had the 'soft' skills needed for the job, but lacked the proper 'hard' skills and training.

Questions

1. As an HR manager what problems do you see in the company?
2. How do you think it can be resolved?

(iii) A Public transport corporation has hired 1000 buses for the different routes for the passengers of metropolitan city. Most of the 3000 crewmen (drivers, conductors, helpers etc.) of these buses have been found to be wanting in satisfactorily dealing with public and daily commuters. They seem to be little interested in the job and the job seem to have lost all meaning to them.

Questions

1. As manager of the public transport company what measures do you suggest to improve the working of crewman in question?
2. Is it possible to modify their behaviour by planning a suitable type of training? Suggest one.

(iv) Ms. Jayshree recently completed her Post Graduate Diploma in Human Resource Management. A few months from now a large steel manufacturing company appointed her as its human resource manager. As of now, the company employs 800 persons and has an expansion plan in hand which may require another 200 persons for various types of additional requirements. Ms. Jayshree has been given complete charge of the company's Human Resource Department.

Questions

1. Point out, what functions is she supposed to perform?
2. What problems do you foresee in her job?
3. What steps is she going to take to perform her job efficiently?
4. How significant is her role in the organisation?

7

CHAPTER

DIRECTING

Grassroot Leadership - Ford Motor Co.

Ford has always attracted and nurtured capable managers and technicians, but it has failed to do the same for change agents and leaders. So, as part of the automaker's cultural overhaul, Ford is embarking on a sweeping attempt to mass-manufacture leaders. It wants to build an army of "warrior-entrepreneurs" — people who have the courage and skills to topple old ideas, and who believe in change passionately enough to make it happen.

Ford will send about 2,500 managers to its Leadership Development Center for one of its four programs — Capstone, Experienced Leader Challenge, Ford Business Associates, and New Business Leader — instilling in them not just the mind-set and vocabulary of a revolutionary but also the tools necessary to achieve a revolution. At the same time, through the Business Leaders Initiative, all 100,000 salaried employees worldwide will participate in business-leadership "cascades," intense exercises that combine trickle-down communications with substantive team projects.

Ford views grassroot leadership as the best vehicle for creating a successful business.

Adapted from an article on http://www.fastcompany.com/online/33/ford.html

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- Explain the concept of directing and its importance in business organisations;
- Understand the principles guiding directing process;
- Explain the meaning of supervision and its importance;
- Explain the meaning of motivation and its importance in business management;
- Understand and explain Maslow's theory of hierarchy of needs and its application to motivation of employees in an organisation;
- Explain the financial and non-financial incentives through which managers motivate their employees;
- Explain the concept of leadership and its importance in management;
- Describe the qualities of a good leader;
- Explain about formal and informal communications in the organisations; and
- Identify various barriers to effective communications and measures to overcome these barriers in the organisations.

Introduction

The above case reveals how important it is to instill leadership qualities in all managers. Business organisations have always given due importance to its managers who are capable of leading others. A manager needs to use various ways to lead, motivate and inspire the subordinates and to communicate with them suitably. These ways, discussed in the present chapter, are collectively called the directing function of management.

Meaning

In the ordinary sense, directing means giving instructions and guiding people in doing work. In our daily life, we come across many situations like a hotel owner directing his employees to complete certain activities for organising a function, a teacher directing his student to complete an assignment, a film director directing the artists about how they should act in the film etc. In all these situations, we can observe that directing is done to achieve some predetermined objective.

In the context of management of an organisation, directing refers to the process of instructing, guiding, counselling, motivating and leading people in the organisation to achieve its objectives.

You can observe here that directing is not a mere issue of communication but encompasses many elements like supervision, motivation and leadership. It is one of the key managerial functions performed by every manager. Directing is a managerial process which takes place throughout the life of an organisation.

The main characteristics of directing are discussed below:

(i) *Directing initiates action:* Directing is a key managerial function. A manager has to perform this function along with planning, organising, staffing and controlling while discharging his duties in the organisation. While other functions prepare a setting for action, directing initiates action in the organisation.

(ii) *Directing takes place at every level of management:* Every manager, from top executive to supervisor performs the function of directing. The directing takes place wherever superior – subordinate relations exist.

(iii) *Directing is a continuous process:* Directing is a continuous activity. It takes place throughout the life of the organisation irrespective of people occupying managerial positions. We can observe that in organisations like Infosys, Tata, BHEL, HLL and the managers may change but the directing process continues because without direction the organisational activities can not continue further.

(iv) *Directing flows from top to bottom:* Directing is first initiated at top level and flows to the bottom through organisational hierarchy.

It means that every manager can direct his immediate subordinate and take instructions from his immediate boss.

Importance of Directing

The importance of directing can be understood by the fact that every action in the organisation is initiated through directing only. Directing guides towards achievement of common objectives. Through directing, managers not only tell the people in the organisation as to what they should do, when they should do and how they should do but also see that their instructions are implemented in proper perspective. Very often, this becomes an important factor in the efficient and effective functioning of the organisation. The points which emphasise the importance of directing are presented as follows:

(i) Directing helps to initiate action by people in the organisation towards attainment of desired objectives. For example, if a supervisor guides his subordinates and clarifies their doubts in performing a task, it will help the worker to achieve work targets given to him.

(ii) Directing integrates employees-efforts in the organisation in such a way that every individual effort contributes to the organisational performance. Thus, it ensures that the individuals work for organisational goals. For example, a manager with good leadership abilities will be in a position to convince the employees working under him that individual efforts and team effort will lead to achievement of organisational goals.

(iii) Directing guides employees to fully realise their potential and capabilities by motivating and providing effective leadership. A good leader can always identify the potential of his employees and motivate them to extract work up to their full potential.

(iv) Directing facilitates introduction of needed changes in the organisation. Generally, people have a tendency to resist changes in the organisation. Effective directing through motivation, communication and leadership helps to reduce such resistance and develop required cooperation in introducing changes in the organisation. For example, if a manager wants to introduce new system of accounting, there may be initial resistance from accounting staff. But, if manager explains the purpose, provides training and motivates with additional rewards, the employees may accept change and cooperate with manager.

(v) Effective directing helps to bring stability and balance in the organisation since it fosters cooperation and commitment among the people and helps to achieve balance among various groups, activities and the departments.

Principles of Directing

Providing good and effective directing is a challenging task as it involves many complexities. A manager has to deal with people with diverse background, and expectations. This complicates the directing process. Certain guiding principles of directing may help in directing process. These principles are briefly explained below:

(i) *Maximum individual contribution:* This principle emphasises that directing techniques must help every individual in the organisation to contribute to his maximum potential for achievement of organisational objectives. It should bring out untappted energies of employees for the efficiency of organisation. For example, a good motivation plan with suitable monetary and non-monetary rewards can motivate an employee to contribute his maximum efforts for the organisation as he or she may feel that their efforts will bring them suitable rewards.

(ii) *Harmony of objectives:* Very often, we find that individual objectives of employees and the organisational objectives as understood are conflicting to each other. For example, an employee may expect attractive salary and monetary benefits to fulfill his personal needs. The organisation may expect employees to improve productivity to achieve expected profits. But, good directing should provide harmony by convincing that employee rewards and work efficiency are complimentary to each other.

(iii) *Unity of Command:* This principle insists that a person in the organisation should receive instructions from one superior only. If instructions are received from more than one, it creates confusion, conflict and disorder in the organisation. Adherence to this principle ensures effective direction.

(iv) *Appropriateness of direction technique:* According to this principle, appropriate motivational and leadership technique should be used while directing the people based on subordinate needs, capabilities, attitudes and other situational variables. For example, for some people money can act as powerful motivator while for others promotion may act as effective motivator.

(v) *Managerial communication:* Effective managerial communication across all the levels in the organisation makes direction effective. Directing should convey clear instructions to create total understanding to subordinates. Through proper feedback, the managers should ensure that subordinate understands his instructions clearly.

(vi) *Use of informal organisation:* A manager should realise that informal groups or organisations exist within every formal organisation. He should spot and make use of such organisations for effective directing.

(vii) *Leadership:* While directing the subordinates, managers should exercise good leadership as it can influence the subordinates positively without causing dissatisfaction among them.

(viii) *Follow through:* Mere giving of an order is not sufficient. Managers should follow it up by reviewing continuously whether orders are being implemented accordingly or any problems are being encountered. If necessary, suitable modifications should be made in the directions.

Elements of Direction

The process of directing involves guiding, coaching, instructing, motivating, leading the people in an organisation to achieve organisational objectives. Consider the following examples: (i) A supervisor explains a worker about operations to be carried by him on a lathe machine, (ii) A mining engineer explains about safety precautions to be followed while working in a coal mine, (iii) A Managing Director declares share in the profits to the managers for their contribution to inhance profits of the company, and (iv) A manager inspires his/her employees by playing a lead role in performing a work.

All these examples and many other activities related to directing may broadly be grouped into four categories which are the elements of directing. These are:

(i) Supervision
(ii) Motivation
(iii) Leadership
(iv) Communication

To know more about directing, these elements are discussed in detail.

Supervision

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

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

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

Importance of Supervision

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

(i) Supervisor maintains day-to-day contact and maintains friendly relations with workers. A good supervisor acts as a guide, friend and philosopher to the workers.

(ii) Supervisor acts as a link between workers and management. He conveys management ideas to the workers on one hand and workers problems to the management on the other. This role played by supervisor helps to avoid misunderstandings and conflicts between management and workers/employees.

(iii) Supervisor plays a key role in maintaining group unity among workers placed under his control. He sorts out internal differences

Directing a Dissatisfied Manager

Rashmi Joshi had been a district sales manager with Fine Productions for ten years. She was recognised by her peers and supervisors as a person who managed department in a good way. However, everyone realised that Rashmi was extremely ambitious and was seeking a higher-level management position. When one of her sales representatives did a good job, she would attempt to take the credit. However, if a problem arose, she thought it was not her fault. When the marketing manager retired, Rashmi applied for the position. The company decided to do a thorough search because of the responsibility and importance associated with the position. When the search was concluded, the decision was made to fill the position by a person from outside the company. The consensus of top management was that Rashmi, although a good district sales manager might have difficulties in working with her new peer groups. They felt that she might displease the other managers if she tried to take credit for their work and, as a result, their performance would suffer.

Rashmi was heart-broken. She had wanted that particular job for a long time and had dedicated all her energies towards obtaining it. She became very despondent and her work deteriorated. The department functioned inspite of her, not because of her. Decisions were made slowly if at all and she began to be late with her sales reports. Although her sales staff continued to be productive, Rashmi could not take the credit.

When the new marketing manager took over, one of the first major problems that he confronted was how to motivate and inspire Rashmi to her former level of performance. He recognised that Rashmi had been with the company for a long time but something had to be done to motivate her to perform really well.

and maintains harmony among workers.

(iv) Supervisor ensures performance of work according to the targets set. He takes responsibility for task achievement and motivates his workers effectively.

(v) Supervisor provides good on-the-job training to the workers and employees. A skilled and knowledgeable supervisor can build efficient team of workers.

(vi) Supervisory leadership plays a key role in influencing the workers in the organisation. A supervisor with good leadership qualities can build up high morale among workers.

(vii) A good supervisor analyses the work performed and gives feedback to the workers. He suggests ways and means of developing work skills.

MOTIVATION

The case of Rashmi reveals an important fact of managerial work; it is not always possible to get the best of work from employees merely by exercising formal authority. What makes people to behave the way they do? Why are some people reluctant to do the work though they have ability to do? What should be done to make people work effectively?

For answering these questions, a manager should try to develop insights into causes of behaviour of people. A manager may come across highly committed and hardworking staff or lazy, evasive and superficial workers. He or she may wonder what to do with workers not willing to work to their potential. Psychologists say it is motivation, which stimulates people to take up work voluntarily.

Let us try to understand something about motivation.

Motivation: Motivation means incitement or inducement to act or move. In the context of an organisation, it means the process of making subordinates to act in a desired manner to achieve certain organisational goals.

While discussing about motivation, we need to understand three inter related terms — motive, motivation and motivators. Let us try to know about these terms.

(i) *Motive:* A motive is an inner state that energises, activates or moves and directs behaviour towards goals. Motives arise out of the needs of individuals. Realisation of a motive causes restlessness in the individual which prompts some action to reduce such restlessness. For example, the need for food causes hunger an account of which a man searches for food. Some such motives are – hunger, thirst, security, affiliation, need for comfort, recognition etc.,

(ii) *Motivation:* Motivation is the process of stimulating people to action to accomplish desired goals. Motivation depends upon satisfying needs of people.

(iii) *Motivators:* Motivator is the technique used to motivate people in an organisation. Managers use diverse motivators like pay, bonus, promotion, recognition, praise, responsibility etc., in the organisation to influence people to contribute their best.

Some of the definitions to explain the concept of motivation are given in the above box.

Features of Motivation: The analysis of various definitions and viewpoints on motivation reveals the following features of motivation:

(i) Motivation is an internal feeling. The urge, drives, desires, aspirations, striving or needs of human being, which are internal, influence human behaviour. For example, people may have the urge or desire for possessing a motorbike, comfortable house, reputation in the society. These urges are internal to an individual.

(ii) Motivation produces goal directed behaviour. For example, the promotion in the job may be given to employee with the objective of improving his performance. If the employee is interested in promotion, it helps to produce a behaviour to improve performance.

(iii) Motivation can be either positive or negative. Positive motivation provides positive rewards like increase in pay, promotion, recognition etc., Negative motivation uses negative means like punishment, stopping increments, threatening etc. which also may induce a person to act in the desired way.

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

Definitions on Motivation

Motivation means a process of stimulating people to action to accomplish desired goals

William G. Scout

Motivation refers to the way in which urges, drives, desires, aspirations, strivings or needs direct, control and explain the behaviour of human beings.

Mc Farland

Motivation is a complex force starting with keeping a person at work in an organisation. Motivation is something which moves the person to action and continues him in the course of action already initiated.

Dubin

Motivation is a process which begins with a physiological or psychological need or deficiency which triggers behaviour or a drive that is aimed at a goal or incentive.

Fred Luthans

Motivation Process: Motivation process is based on human needs. A simple model to explain motivation process is presented below.

The following example explains the process of satisfaction of human needs.

Ramu is very hungry since he did not have breakfast in the morning. By1.00 P.M., he became restless and started walking on the road in search of a hotel for snacks or meals. After walking for 2 kms, he could find a hotel where roti and dal was available for Rs. 10. Since he had only Rs. 15 in his pocket, he paid Rs. 10 and had a satisfying meal. After taking a meal, he felt that he had regained energy.

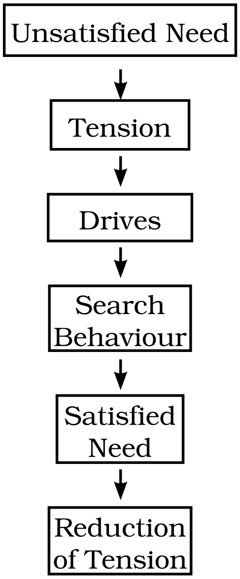
An unsatisfied need of an individual creates tension which stimulates his or her drives. These drives generate a search behaviour to satisfy such need. If such need is satisfied, the individual is relieved of tension.

Motivating Employees in Tata Steel

In Tata Steel several initiatives have been taken to further improve the motivation levels and participation in the decision making process of the officers, greater impetus to training through a formalised system of a personal development programme, talent review and job rotation systems, compensation linked to the performance management system, formal rewards and recognition systems, knowledge management systems linked with appraisals, leadership opportunities in quality circles, continuous improvement and value engineering programmes and an extremely transparent and credible multi-path communication system to address queries and concerns of all employees through various dialogues both formal and online, with such tools as video conferencing, 'MD Online', special dialogues with senior management, meetings, conferences and seminars. These initiatives have helped to build a homogeneous and focused team in Tata Steel, increasing motivation and binding to the vision of the company and spurred employees to deliver targets on a participatory management basis leading to ownership of processes.

Tata Steel is a company that actively promotes freedom to work, freedom to innovate and even the freedom to fail. It is a nimble, fast, modern and forward-looking company on a strong growth path. The company has undergone a revolutionary change in terms of its production facilities and the technology in the manufacturing process. These changes have resulted in creating greater opportunities for taking up newer challenges for young recruits work and for performance based on IT enabled systems and high levels of automation. These have led to making the company one of the lowest cost producers of steel and the only Indian company to be recognised by the World Steel Dynamics as one of the top most 'World Class' steel makers. Tata Steel hopes not only to consolidate but better its leadership by robust leadership development systems that have seen the company create many CEOs for other companies.

http://www.tata.com/tata_steel/releases/20030829.htm



Importance of Motivation: In the example of Tata Steel you have seen how the direction, motivation and effective leadership has taken the company forward. Even communication systems in the company have encouraged employees to achieve targets.

Motivation is considered important because it helps to identify and satisfy the needs of human resources in the organisation and thereby helps in improving their performance. It is the reason why every major organisation develops various kinds of motivational programmes and spends crores of rupees on these programmes. The importance of motivation can be pointed out by the following benefits:

(i) Motivation helps to improve performance levels of employees as well as the organisation. Since proper motivation satisfies the needs of employees, they in turn devote all their energies for optimum performance in their work. A satisfied employee can always turnout expected performance. Good motivation in the organisation helps to achieve higher levels of performance as motivated employees contribute their maximum efforts for organisational goals.

(ii) Motivation helps to change negative or indifferent attitudes of employee to positive attitudes so as to achieve organisational goals. For example, a worker may have indifferent or negative attitude towards his work, if he is not rewarded properly. If suitable rewards are given and supervisor gives positive encouragement and praise for the good work done, the worker may slowly develop positive attitude towards the work.

(iii) Motivation helps to reduce employee turnover and thereby saves the cost of new recruitment and training. The main reason for high rate of employee turnover is lack of motivation. If managers identify motivational needs of employees and provide suitable incentives, employees may not think of leaving the organisation. High rate of turnover compels management to go for new recruitment and training which involve additional investment of money, time and effort. Motivation helps to save such costs. It also helps to retain talented people in the organisation.

(iv) Motivation helps to reduce absenteeism in the organisation. Some important reasons for absenteeism are–bad working conditions, inadequate rewards, lack of recognition, poor relations with supervisors and colleagues etc. Through sound motivational system, all these deficiencies can be covered. If motivation is adequately provided, work becomes a source of pleasure and workers attend to the work regularly.

(v) Motivation helps managers to introduce changes smoothly without much resistance from people. Normally, for any change introduced in the organisation, there may be resistance for changes. If manager can convince employees that proposed changes will bring additional rewards to employees, they may readily accept the change.

Maslow's Need Hierarchy Theory of Motivation: Since motivation is highly complex, many researchers have studied about motivation from several dimensions and developed some theories. These theories help to develop understanding about motivation phenomenon. Among these, Maslow's Need Hierarchy Theory is considered fundamental to understanding of motivation. Let us examine it in detail.

Abraham Maslow, a well-known Psychologist in a classic paper published in 1943, outlined the elements of an overall theory of motivation.

His theory was based on human needs. He felt that within every human being, there exists a hierarchy of five needs. These are:

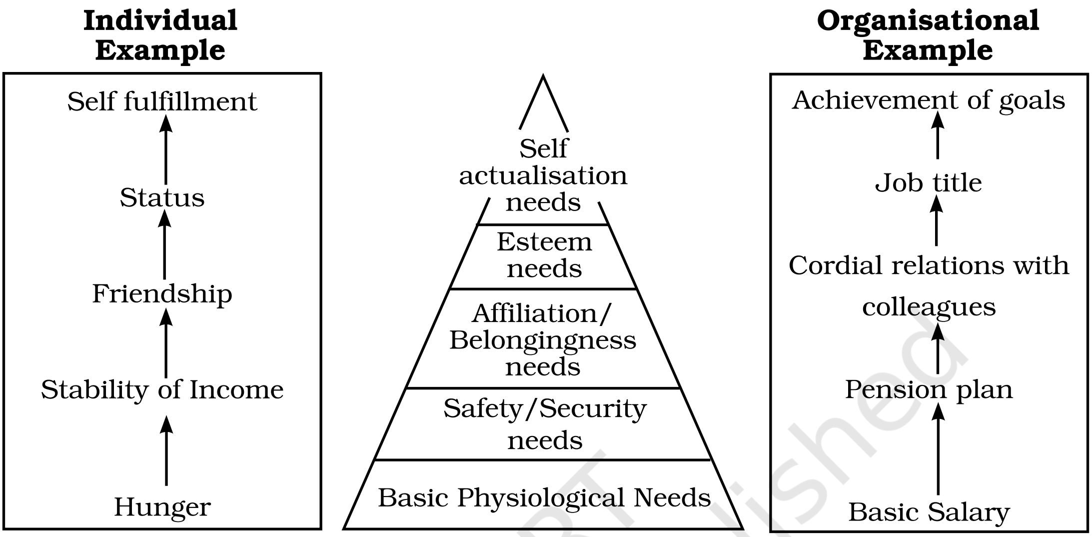
(i) *Basic Physiological Needs:* These needs are most basic in the hierarchy and corresponds to primary needs. Hunger, thirst, shelter, sleep and sex are some examples of these needs. In the organisational context, basic salary helps to satisfy these needs.

(ii) *Safety/Security Needs:* These needs provide security and protection from physical and emotional harm. Examples: job security, stability of income, Pension plans etc.,

(iii) *Affiliation/Belonging Needs:* These needs refer to affection, sense of belongingness, acceptance and friendship.

(iv) *Esteem Needs:* These include factors such as self-respect, autonomy status, recognition and attention.

(v) *Self Actualisation Needs:* It is the highest level of need in the hierarchy. It refers to the drive to become what one is capable of



Maslow's Need Hierarchy Theory

becoming. These needs include growth, self-fulfillment and achievement of goals.

Maslow's theory is based on the following assumptions:

(i) People's behaviour is based on their needs. Satisfaction of such needs influences their behaviour.

(ii) People's needs are in hierarchical order, starting from basic needs to other higher level needs.

(iii) A satisfied need can no longer motivate a person; only next higher level need can motivate him.

(iv) A person moves to the next higher level of the hierarchy only when the lower need is satisfied.

Maslow's Theory focuses on the needs as the basis for motivation. This theory is widely recognised and appreciated. However, some of his propositions are questioned on his classification of needs and hierarchy of needs. But, despite such criticism, the theory is still relevant because needs, no matter how they are classified, are important to understand the behaviour. It helps managers to realise that need level of employee should be identified to provide motivation to them.

Financial and Non-Financial Incentives

Incentive means all measures which are used to motivate people to improve performance. These incentives may be broadly classified as financial and non financial. Let us learn about these incentives in detail.

Financial Incentives: In the context of existing economic system, money

Profile of Abraham Maslow (1908 – 1970)

Abraham H. Maslow was born in Brooklyn, New York, in 1908. He studied primate behavior at the University of Wisconsin, where he received his doctorate in psychology in 1934.

Early in his career, Maslow was drawn to the study of human motivation and personality. His work in this area upset strict behaviorists, whose explanations of motivation and personality failed to account for what Maslow called the whole person. His theory of the hierarchy of needs, which leads to the 'self-actualised' individual, was a strong catalyst for the founding of humanistic psychology. Maslow successfully bridged motivation and personality in his theories of needs, self-actualising persons, and peak experiences.

Maslow is considered an important figure in contemporary psychology. His career was a formidable one. For 14 years he taught at Brooklyn College, and then went to Brandeis University as chairman of the Psychology Department. In 1968 he was elected president of the American Psychological Association. In 1969 he went to the Laughlin Foundation in Menlo Park, California. He wrote two important books: Toward a Psychology of Being (1968) and Motivation and Personality (1970). Abraham Maslow died of a heart attack in 1970.

has become a means to satisfy the physical needs of daily life and also of obtaining social position and power. Since, money has the purchasing power, it becomes a very important incentive for every individual.

Financial incentives refer to incentives which are in direct monetary form or measurable in monetary term and serve to motivate people for better performance. These incentives may be provided on individual or group basis. The financial incentives generally used in organisations are listed below:

(i) *Pay and allowances:* For every employee, salary is the basic monetary incentive. It includes basic pay, dearness allowance and other allowances. Salary system consists of regular increments in the pay every year and enhancement of allowances from time-to-time. In some business organisations, pay hike and increments may be linked to performance.

(ii) *Productivity linked wage incentives:* Several wage incentive plans aims at linking payment of wages to increase in productivity at individual or group level.

(iii) *Bonus:* Bonus is an incentive offered over and above the wages/ salary to the employees.

(iv) *Profit Sharing:* Profit sharing is meant to provide a share to employees in the profits of the organisation. This serves to motivate the employees to improve their performance and contribute to increase in profits.

(v) *Co-partnership/ Stock option:* Under these incentive schemes, employees are offered company shares at a set price which is lower than market price. Sometimes, management may allot shares in line of various incentives payable in cash. The allotment of shares creates a feeling of ownership to the employees and makes them to contribute for the growth of the organisation. In Infosys the scheme of stock option has been implemented as a part of managerial compensation.

(vi) *Retirement Benefits:* Several retirement benefits such as provident fund, pension, and gratuity provide financial security to employees after their retirement. This acts as an incentive when they are in service in the organisation.

(vii) *Perquisites:* In many companies perquisites and fringe benefits are offered such as car allowance, housing, medical aid, and education to the children etc., over and above the salary. These measures help to provide motivation to the employees/ managers.

Non-Financial Incentives: All the needs of individuals are not satisfied by money alone. Psychological, social and emotional factors also play important role in providing motivation. Non-financial incentives mainly focus on these needs. Some times, monetary aspect may be involved in non-financial incentives as well. However, the emphasis is to provide psychological and emotional satisfaction rather than money driven satisfaction. For example, if an individual gets promotion in the organisation, it satisfies him psychologically more as he gets a feeling of elevation, increase in status, increase in authority, challenge in the job etc., Though promotion involves payment of extra money, non-monetary aspects over-ride monetary aspects.

Some of the important non-financial incentives are discussed below:

(i) *Status:* In the organisational context, status means ranking of positions in the organisation. The authority, responsibility, rewards, recognition, perquisites and prestige of job indicate the status given to a person holding a managerial position. Psychological, social and esteem needs of an individual are satisfied by status given to their job.

(ii) *Organisational Climate:* Organisational climate indicates the characteristics which describe an organisation and distinguish one organisation from the other. These characteristics influence the behaviour of individuals in the organisation. Some of these characteristics are–individual autonomy, reward orientation, consideration to employees, risk-tasking etc., If managers take positive measures regarding these aspects, it helps to develop better organisational climate.

(iii) *Career Advancement Opportunity:* Every individual wants to grow to the higher level in the organisation. Managers should provide opportunity to employees to improve their skills and be promoted to the higher level jobs. Appropriate skill development programmes, and sound promotion policy will help employees to achieve promotions. Promotion works as a tonic and encourages employees to exhibit improved performance.

(iv) *Job Enrichment:* Job enrichment is concerned with designing jobs that include greater variety of work content, require higher level of knowledge and skill; give workers more autonomy and responsibility; and provide the opportunity for personal growth and a meaningful work experience. If jobs are enriched and made interesting, the job itself becomes a source of motivation to the individual.

(v) *Employee Recognition programmes:* Most people have a need for evaluation of their work and due recognition. They feel that what they do should be recognised by others concerned. Recognition means acknowledgment with a show of appreciation. When such appreciation is given to the work performed by employees, they feel motivated to perform/work at higher level. Some examples of employee recognition are:

- Congratulating the employee for good performance.
- Displaying on the notice board or in the company news letter about the achievement of employee.
- Installing award or certificate for best performance.
- Distributing mementos, complimentaries like T-shirts in recognition of employee services.
- Rewarding an employee for giving valuable suggestions.

(vi) *Job security:* Employees want their job to be secure. They want certain stability about future income and work so that they do not feel worried on these aspects and work with greater zeal. In India, this aspect is more important considering the inadequate job opportunities and too many aspirants for these. However, there is one negative aspect of job security. When people feel that they are not likely to lose their jobs, they may become complacent.

(vii) *Employee participation:* It means involving employees in decision making of the issues related to them. In many companies, these programmes are in practice in the form of joint management committees, work committees, canteen committees etc.,

(viii) *Employee Empowerment:* Empowerment means giving more autonomy and powers to subordinates. Empowerment makes people feel that their jobs are important. This feeling contributes positively to the use of skills and talents in the job performance.

LEADERSHIP

Whenever we hear the success stories of any organisation, we are immediately reminded of their leaders. Can you imagine Mircrosoft without Bill Gates, Reliance Industries without Ambanis, Infosys without Narayana Murthy, Tata without J.R.D. Tata or Wipro without Azim Premji. You would say it is not possible to achieve success without such great leaders. The leaders always play a key role for the success and excellence of any organisation.

Let us understand the concept of leadership, its importance and qualities of good leaders. Leadership is the process of influencing the behaviour of people by making them strive voluntarily towards achievement of organisational goals. Leadership indicates the ability of an individual to maintain good interpersonal relations with followers and motivate them to contribute for achieving organisational objectives.

Features of leadership

An examination of the above definition reveals the following important features of leadership:

(i) Leadership indicates ability of an individual to influence others.

Definitions of Leadership

Leadership is the activity of influencing people to strive willingly for group objectives.

George Terry

Leadership is the art or process of influencing people so that they will strive willingly and enthusiastically towards the achievement of group goals.

Harold Koontz and Heinz Weihrich

Leadership is a set of interpersonal behaviours designed to influence employees to cooperate in the achievement of objectives.

Glueck

Leadership is both a process and property. The process of leadership is the use of non-coercive influence to direct and coordinate the activities of the members of an organised group towards the accomplishment of group objectivities. As a property, leadership is the set of qualities or characteristics attributed to those who are perceived to successfully employ such influence.

Gay and Strake

(ii) Leadership tries to bring change in the behaviour of others.

(iii) Leadership indicates interpersonal relations between leaders and followers.

(iv) Leadership is exercised to achieve common goals of the organisation.

(v) Leadership is a continuous process.

The term leader emerges from leadership. An individual possessing attributes of leadership is known as leader. While discussing about leadership, it is important to understand leader–follower relationship. Many times, the success of an organisation is attributed to the leader, but due credit is not given to the followers. Many followers related factors like – their skills, knowledge, commitment, willingness to cooperate, team spirit etc., make a person an effective leader. It is said that followers make a person, a good leader by acceptance of leadership. Therefore, it is to be recognised that both leader and follower play key role in leadership process.

Importance of Leadership: Leadership is a key factor in making any organisation successful. History reveals that, many times, difference between success and failure of an organisation is leadership. It is aptly mentioned by Stephen Covey, a famous management consultant, that managers are important but leaders are vital for lasting organisational success. A leader not only commits

Effective leadership is getting work done, tasks completed on time and goals achieved at minimum cost

his followers to organisational goals but also pools needed resources, guides and motivates subordinates to reach the goals.

The importance of leadership can be discussed from the following benefits to the organisation:

(i) Leadership influences the behaviour of people and makes them to positively contribute their energies for the benefit of the organisation. Good leaders always produce goods results through their followers.

(ii) A leader maintains personal relations and helps followers in fulfilling their needs. He provides needed confidence, support and encouragement and thereby creates congenial work environment.

(iii) Leader plays a key role in introducing required changes in the organisation. He persuades,

Leadership at Infosys

It is interesting and inspiring to know about N. R. Narayana Murthy, Ex-Chairman of Infosys, an IT legend, institution builder, a leader par excellence and embodiment of directing abilities.

Born on August 20, 1946 in Karnataka State, Mr. Narayana Murthy graduated (B.E.) from University of Mysore (1967), and obtained master degree (M.Tech) from IIT, Kanpur in 1969. He started his career as head of the computer centre at IIM, Ahmedabad.

He started Infosys, a small software company along with his friends in 1981 and turned it into a global IT company by 2002. He was the chief mentor, CEO of the company for two decades. During that time he took the company to unimaginable heights. With an equity capital of Rs. 10,000 in 1981, Infosys market capitalisation reached Rs. 11 billion by 2001. Infosys became one of the biggest exporter of software from India. It is the first company to be listed in Nasdaq Stock Market in 1999.

Narayana Murthy is remembered as a top leader for many things. He had supreme confidence on his team members, executives and workers. He nurtured and developed leadership qualities through coaching and training. He started Infosys Leadership Institute in early 2001 to help promising infoscians to develop into global leaders.

Mr. Murthy leads by example and by trust. Very often he used to say "A true leader is one who leads by example and sacrifices more than any one else, in his or her pursuit of excellence". He truly practiced and proved it in Infosys.

Mr. Murthy always motivated his team. He introduced number of motivational schemes including the novel Stock option scheme for the executives of Infosys.

Narayana Murthy was associated with many national and international bodies in different capacities and extended his services to the wide ranging activities. He received number of awards and rewards from academic, social and business community. Following the norms setup by himself, Narayana Murthy handed over reins of Infosys to his friend and co-founder Nandan Nilekani in 2002.

clarifies and inspires people to accept changes whole-heartedly. Thus, he overcomes the problem of resistance to change and introduces it with minimum discontentment.

(iv) A leader handles conflicts effectively and does not allow adverse effects resulting from the conflicts. A good leader always allows his followers to ventilate their feelings and disagreement but persuades them by giving suitable clarifications.

(v) Leader provides training to their subordinates. A good leader always builds up his successor and helps in smooth succession process.

Qualities of Good Leader: What are the qualities possessed by a good leader? Are there any common traits (qualities) applicable to all good leaders? How many such qualities should a leader possess to be successful?

One approach to leadership emphasises that a person should possess certain qualities or traits to become a successful leader. It assumes that leaders can be distinguished from non leaders by certain unique traits possessed by them. The qualities of

Qualities of a Good Leader

In all about 18,000 traits were identified by researchers. The qualities of a good leader as mentioned by some authorities on the subject are given below:

Energy, emotional stability, knowledge of human relations, motivation, communication, skill, teaching ability, social skill and technical competence.

Geroge Terry

Vitality and endurance, decisiveness, persuasiveness, stability in behaviour, intellectual ability and knowledge.

Chester Barnard

Physical and nervous energy, enthusiasm, sense of purpose and direction, technical mastery, friendliness and affection, decisiveness.

Ordway Tead

Courage, will power, judgment, flexibility, knowledge and integrity.

Vicout Slim

Supervisory ability, achievement motivation, self-actualising, intelligence, self assurance, decisiveness.

Ghiselli

Courage, self-confidence, moral qualities, self sacrifice, paternalism, fairness.

Hill

Physical and constitutional factors, intelligence, self-confidence, sociability, will, dominance.

Stodgil

good leaders as identified by some researchers are shown in the box in previous page.

Some of these qualities are explained below:

(i) *Physical features:* Physical features like height, weight, health, appearance determine the physical personality of an individual. It is believed that good physical features attract people. Health and endurance help a leader to work hard which inspires others to work with same tempo.

(ii) *Knowledge:* A good leader should have required knowledge and competence. Only such person can instruct subordinates correctly and influence them.

(iii) *Integrity:* A leader should posses high level of integrity and honesty. He should be a role model to others regarding the ethics and values.

(iv) *Initiative:* A leader should have courage and initiative. He should not wait for opportunities come to his way, rather he should grab the opportunity and use it to the advantage of organisation.

(v) *Communication skills:* A leader should be a good communicator. He should have the capacity to clearly explain his ideas and make the people to understand his ideas. He should be not only good speaker but a good listener, teacher, counsellor and persuader.

(vi) *Motivation skills:* A leader should be an effective motivator. He should understand the needs of people and motivate them through satisfying their needs.

(vii) *Self Confidence:* A leader should have high level of self confidence. He should not loose his confidence even in most difficult times. In fact, if the leader lacks self

Leadership and Team work in HCL Technologies

HCL Technologies has formulated a rather innovative approach to management, where employees come before customers. Every employee ranks their boss, their boss's boss, and at least three other company managers on a 1-to-5 scale. Then the results are posted online for everyone to see.

This company realizes that satisfied and secure employees can best focus on customer success. HCL has formed new strategic alliances, and is embarking on a rather innovative approach to shared risk with customers.

The point is that Indian companies aren't just innovating manufacturing methods,technologies, and product design. Their leaders are also re-thinking leadership and management to create energised creative teams of employees focused on customer success.

Source: http://www.evolvingexcellence.com/blog/2006/04/the_future_of_m.html confidence, he can not provide confidence to his followers.

(viii) *Decisiveness:* Leader should be decisive in managing the work. Once he is convinced about a fact, he should be firm and should not change opinions frequently.

(ix) *Social skills:* A leader should be sociable and friendly with his colleagues and followers. He should understand people and maintain good human relations with them.

However, we should remember that all good leaders may not necessarily posses all the qualities of a good leader. In fact, it is not possible for any individual to have all the qualities. But an understanding about these qualities help the managers to acquire them through training and conscious efforts.

Leadership Style

There are many theories of leadership behaviour and styles. Research studies have revealed certain traits and qualities which a leader might possess. However, these are not conclusive since many people may possess these qualities but may not be leaders.

There are several bases for classifying leadership styles. The most popular classification of leadership styles is based on the use of authority. Depending on the use of authority, there are three basic styles of leadership:

(i) Autocratic (ii) Democratic, and
(iii) Laissez-faire

(i) Autocratic or Authoritarian leader

An autocratic leader gives orders and expects his subordinates to obey those orders. If a manager is following this style, then communication is only one-way with the subordinate only acting according to the command given by the manager.

This leader is dogmatic i.e., does not change or wish to be contradicted. His following is based on the assumption that reward or punishment both can be given depending upon the result. This leadership style is effective in getting productivity in many situations like in a factory where the supervisor is responsible for production on time and has to ensure labour productivity. Quick decision-making is also facilitated.

But there are variations also, they may listen to everyone's opinion, consider subordinates ideas and concerns but the decision will be their own.

(ii) Democratic or Participative leader

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

(iii) Laissez faire or Free-rein leader Such a leader does not believe in the use of power unless it is absolutely essential. The followers are given a high degree of independence to formulate their own objectives and ways to achieve them. The group members work on their own tasks resolving issues themselves. The manager is there only to support them and supply them the required information to complete the task assigned. At the same time, the subordinate assumes responsibility for the work to be performed.

Depending upon the situation a leader may choose to exercise a combination of these styles when required. Even a laissez faire leader would have certain rules to be followed while doing work and a democratic leader may have to take his own decision in an emergency situation.

COMMUNICATION

Communication plays key role in the success of a manager. How much professional knowledge and intelligence a manager possesses becomes immaterial if he is not able to communicate effectively with his subordinates and create understanding in them. Directing abilities of a manager mainly depend upon his communication skills. That is why organisation always emphasise on improving communication skills of managers as well as employees.

The word communication has been derived from the Latin word 'communis' which means 'common' which consequently implies common understanding. Communication is defined in different ways. Generally, it is understood as a process of exchange of ideas, views, facts, feelings etc.,

Definitions of Communication

Communication is the sum of all things one person does when he wants to create understanding in the mind of another. It involves systematic and continuous process of telling, listening and understanding.

Louis Allen

Communication is transfer of information from the sender to the receiver with the information being understood by the receiver.

Harold Koontz and Heniz Weihrich

Communication is a process by which people create and share information with one another in order to reach common understanding.

Rogers

Effective Communication increases managerial efficiency

between or among people to create common understanding.

Some of the definitions given by management experts are presented in the box.

A close examination of above definitions reveals that communication is the process of exchange of information between two or more persons to reach common understanding.

Elements of Communication Process

Communication has been defined as a process. This process involves elements like source, encoding, media/channel, receiver, decoding, noise and feedback. The process is represented in the figure.

The elements involved in communication process are explained below:

(i) *Sender:* Sender means person who conveys his thoughts or ideas to the receiver. The sender represents source of communication.

(ii) *Message:* It is the content of ideas, feelings, suggestions, order etc., intended to be communicated.

(iii) *Encoding:* It is the process of converting the message into communication symbols such as words, pictures, gestures etc.,

(iv) *Media:* It is the path through which encoded message is transmitted to receiver. The channel may be in written form, face to face, phone call, internet etc.,

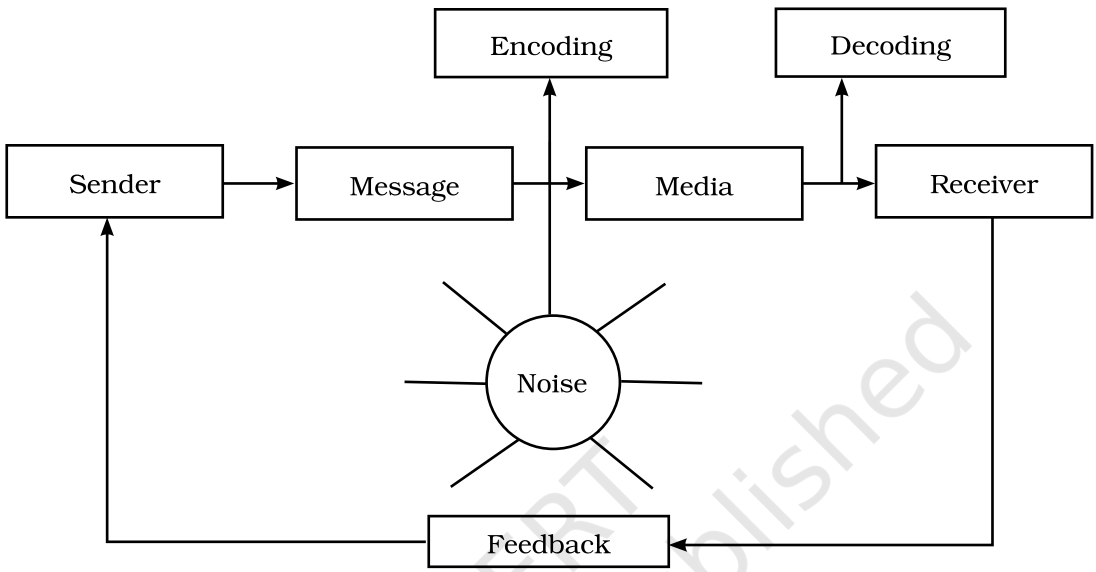
(v) *Decoding:* It is the process of converting encoded symbols of the sender.

(vi) *Receiver:* The person who receives communication of the sender.

(vii) *Feedback:* It includes all those actions of receiver indicating that he has received and understood message of sender.

(viii) *Noise:* Noise means some obstruction or hindrance to communication. This hindrance may be caused to sender, message or receiver. Some examples of noise are:

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



Communication Process

Importance of Communication

Communication is one of the most central aspects of managerial activities. It has been estimated that a manager spends 90 percent of his time in communicating-reading, writing, listening, guiding, instructing, approving, reprimanding, etc. Effectiveness of a manager depends significantly on his ability to communicate effectively with his superiors, subordinates and external agencies such as bankers, suppliers, union and government.

An ex-president of American Management Association once observed that number one management problem today is communication. Bernard has called it the foundation of all group activities. Communication serves as the lubricant fostering for the smooth operations of the management process. The importance of communication in management can be judged from the following:

(i) *Acts as basis of coordination:* Communication acts as basis of coordination. It provides coordination among departments, activities and persons in the organisation. Such coordination is provided by explaining about organisational goals, the mode of their achievement and inter relationships between different individuals etc.

(ii) *Helps in smooth working of an enterprise:* Communication makes possible for the smooth and unrestricted working of the enterprise. All organisational interactions depend on communications. The job of a manager is to coordinate the human and physical elements of an organisation into an efficient and active working unit that achieves common objectives. It is only communication which makes smooth working of an enterprise possible. Communication is basic to an organisation's existence-right from its birth through its continuing life. When communication stops, organised activity ceases to exist.

(iii) *Acts as basis of decision making:* Communication provides needed information for decision making. In its absence, it may not be possible for the managers to take any meaningful decision. Only on the basis of communication of relevant information one can take right decision.

(iv) *Increases managerial efficiency:* Communication is essential for quick and effective performance of managerial functions. The management conveys the goals and targets, issues instructions, allocates jobs and responsibilities and looks after the performance of subordinates. Communication is involved in all these aspects. Thus, communication lubricates the entire organisation and keeps the organisation at work with efficiency.

(v) *Promotes cooperation and industrial peace:* Efficient operation is the aim of all prudent management. It may be possible only when there is industrial peace in the factory and mutual cooperation between management and workers. The two way communication promotes cooperation and mutual understanding between the management and workers.

(vi) *Establishes effective leadership:* Communication is the basis of leadership. Effective communication helps to influence subordinates. While influencing people, leader should possess good communication skills.

(vii) *Boosts morale and provides motivation:* An efficient system of communication enables management to motivate, influence and satisfy the subordinates. Good communication assists the workers in their adjustment with the physical and social aspect of work. It improves good human relations in industry. Communication is the basis of participative and democratic pattern of management. Communication helps to boost morale of employees and managers.

Formal and Informal Communciation

Communication taking place within an organisation may be broadly classified as formal and informal communication.

Formal Communication

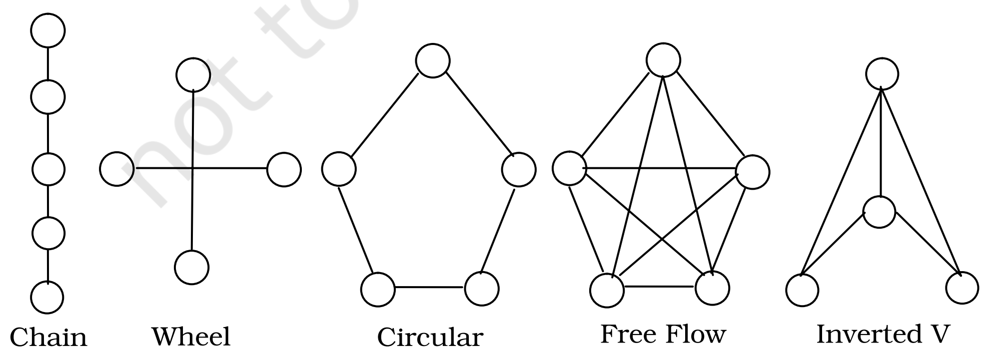
Formal communication flows through official channels designed in the organisation chart. This communication may take place between a superior and subordinate, a subordinate and superior or among same cadre employees or managers. The communications may be oral or written but generally recorded and filed in the office.

Formal communication may be further classified as – Vertical and Horizontal.

Vertical communication flows vertically i.e., upwards or downwards through formal channels. Upward communications refer to flow of communication from subordinate to superior whereas downward communication indicates communication from a superior to subordinate. The examples of upward communication are – application for grant of leave, submission of progress report, request for grants etc. Similarly, the examples of downward communication include – sending notice to employees to attend a meeting, ordering subordinates to complete an assigned work, passing on guidelines framed by top management to the subordinates etc.

Horizontal or lateral communication takes place between one division and another. For example, a production manager may contact marketing manager to discuss about schedule of product delivery, product design, quality etc.

The pattern through which communication flows within the organisation is generally indicated through communication network. Different types of communication networks may operate in formal organisation. Some of the popular communication networks are presented and discussed in given figure.



Communication Network

(i) *Single chain:* This network exists between a supervisor and his subordinates. Since many levels exist in an organisation structure, communication flows from every superior to his subordinate through single chain.

(ii) *Wheel:* In wheel network, all subordinates under one superior communicate through him only as he acts as a hub of the wheel. The subordinates are not allowed to talk among themselves.

(iii) *Circular:* In circular network, the communication moves in a circle. Each person can communicate with his adjoining two persons. In this network, communication flow is slow.

(iv) *Free flow:* In this network, each person can communicate with others freely. The flow of communication is fast in this network.

(v) *Inverted V:* In this network, a subordinate is allowed to communicate with his immediate superior as well as his superiors superior. However, in later case, only prescribed communication takes place.

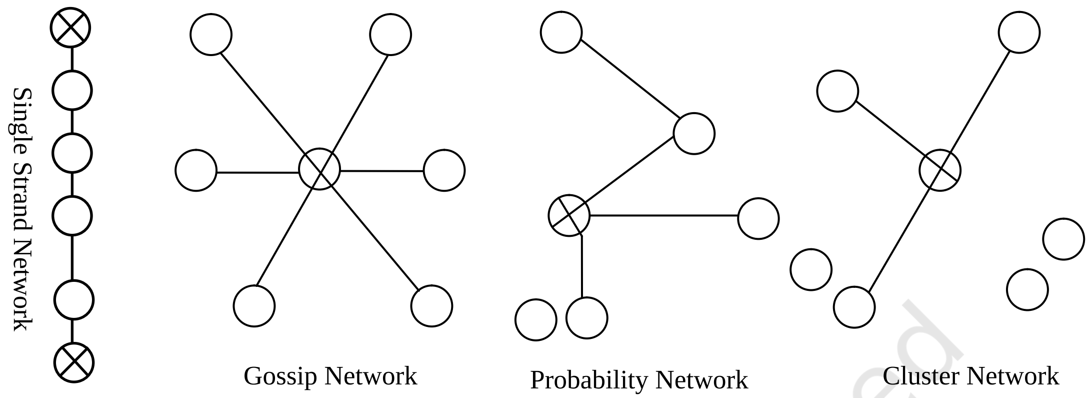
Informal Communication

Communication that takes place without following the formal lines of communication is said to be informal communication. Informal system of communication is generally referred to as the 'grapevine' because it spreads throughout the organisation with its branches going out in all directions in utter disregard to the levels of authority.

The informal communication arises out of needs of employees to exchange their views, which cannot be done through formal channels. Workers chit chating in a canteen about the behaviour of the superior, discussing about rumours that some employees are likely to be transferred are some examples of informal communications. The grapevine/ informal communication spreads rapidly and sometimes gets distorted. It is very difficult to detect the source of such communication. It also leads to generate rumours which are not authentic. People's behaviour is affected by rumours and informal discussions and sometimes may hamper work environment. Sometimes, grapevine channels may be helpful as they carry information rapidly and, therefore, may be useful to the manager at times. Informal channels are used by the managers to transmit information so as to know the reactions of his/her subordinates. An intelligent manager should make use of positive aspects of informal channels and minimise negative aspects of this channel of communication.

Grapevine Network

Grapevine communication may follow different types of network. Some of these networks are shown in figure on page 205.



Grapevine Communication Networks

In single strand network, each person communicates to the other in sequence. In gossip network, each person communicates with all on non-selective basis. In probability network, the individual communicates randomly with other individual. In cluster, the individual communicates with only those people whom he trusts. Of these four types of networks, cluster is the most popular in organisations.

Barriers to Communication

It is generally observed that managers face several problems due to communication breakdowns or barriers. These barriers may prevent a communication or filter part of it or carry incorrect meaning due to which misunderstandings may be created. Therefore, it is important for a manager to identity such barriers and take measures to overcome them.

The barriers to communication in the organisations can be broadly grouped as: semantic barriers, psychological barriers, organisational barriers, and personal barriers. These are briefly discussed below:

Semantic barriers: Semantics is the branch of linguistics dealing with the meaning of words and sentences. Semantic barriers are concerned with problems and obstructions in the process of encoding and decoding of message into words or impressions. Normally, such barriers result on account of use of wrong words, faulty translations, different interpretations etc. These are discussed below:

(i) *Badly expressed message:* Some times intended meaning may not be conveyed by a manager to his subordinates. These badly expressed messages may be an account of inadequate vocabulary, usage of wrong words, omission of needed words etc.

Communication Grapevine

(ii) *Symbols with different meanings:* A word may have several meanings. Receiver has to perceive one such meaning for the word used by communicator. For example, consider these three sentences where the work 'value' is used:

(a) What is the value of this ring?

(b) I value our friendship.

(c) What is the value of learning computer skills?

You will find that the 'value' gives different meaning in different contexts. Wrong perception leads to communication problems.

(iii) *Faulty translations:* Sometimes the communications originally drafted in one language (e.g., English) need to be translated to the language understandable to workers (e.g., Hindi). If the translator is not proficient with both the languages, mistakes may creep in causing different meanings to the communication.

(iv) *Unclarified assumptions:* Some communications may have certain assumptions which are subject to different interpretations. For example, a boss may instruct his subordinate, "Take care of our guest". Boss may mean that subordinate should take care of transport, food, accommodation of the guest until he leaves the place. The subordinate may interpret that guest should be taken to hotel with care. Actually, the guest suffers due to these unclarified assumptions.

(v) *Technical jargon:* It is usually found that specialists use technical jargon while explaining to persons who are not specialists in the concerned field. Therefore, they may not understand the actual meaning of many such words.

(vi) *Body language and gesture decoding:* Every movement of body communicates some meaning. The body movement and gestures of communicator matters so much in conveying the message. If there is no match between what is said and what is expressed in body movements, communications may be wrongly perceived.

Psychological barriers: Emotional or psychological factors acts as barriers to communicators. For example, a worried person cannot communicate properly and an angry receiver cannot understand the real meaning of message. The state of mind of both sender and receiver of communication reflects in the effective communication. Some of the psychological barriers are:

(i) *Premature evaluation:* Some times people evaluate the meaning of message before the sender completes his message. Such premature evaluation may be due to pre-conceived notions or prejudices against the communication.

(ii) *Lack of attention:* The pre-occupied mind of receiver and the resultant non-listening of message acts as a major psychological barrier. For instance, an employee explains about his problems to the boss who is pre-occupied with an important file before him. The boss does not grasp the message and the employee is disappointed.

(iii) *Loss by transmission and poor retention:* When communication passes through various levels, successive transmissions of the message results in loss of, or transmission of inaccurate information. This is more so in case of oral communication.
Poor retention is another problem. Usually people cannot retain the information for a long time if they are inattentive or not interested.

(iv) *Distrust:* Distrust between communicator and communicate acts as a barrier. If the parties do not believe each other, they can not understand each others message in its original sense.

Organisational barriers: The factors related to organisation structure, authority relationships, rules and regulations may, sometimes, act as barriers to effective communication. Some of these barriers are:

(i) *Organisational policy:* If the organisational policy, explicit or implicit, is not supportive to free flow of communication, it may hamper effectiveness of communications. For example, in an organisation with highly centralised pattern, people may not be encouraged to have free communication.

(ii) *Rules and regulations:* Rigid rules and cumbersome procedures may be a hurdle to communication. Similarly, communications through prescribed channel may result in delays.

(iii) *Status:* Status of superior may create psychological distance between him and his subordinates. A status conscious manager also may not allow his subordinates to express their feelings freely.

(iv) *Complexity in organisation structure:* In an organisation where there are number of managerial levels, communication gets delayed and distorted as number of filtering points are more.

(v) *Organisational facilities:* If facilities for smooth, clear and timely communications are not provided communications may be hampered. Facilities like frequent meetings, suggestion box, complaint box, social and cultural gathering, transparency in operations etc., will encourage free flow of communication. Lack of these facilities may create communication problems.

Personal barriers: The personal factors of both sender and receiver may exert influence on effective communication. Some of the personal barriers of superiors and subordinates are mentioned below:

(i) *Fear of challenge to authority:* If a superior perceives that a particular communication may adversely affect his authority, he or she may withhold or suppress such communication.

(ii) *Lack of confidence of superior on his subordinates:* If superiors do not have confidence on the competency of their subordinates, they may not seek their advice or opinions.

(iii) *Unwillingness to communicate:* Sometimes, subordinates may not be prepared to communicate with their superiors, if they perceive that it may adversely affect their interests.

(iv) *Lack of proper incentives:* If there is no motivation or incentive for communication, subordinates may not take initiative to communicate. For example, if there is no reward or appreciation for a good suggestion, the subordinates may not be willing to offer useful suggestions.

Improving Communication Effectiveness

The barriers to effective communication exists in all organisations to a greater or lesser degree. Organisations keen on developing effective communication should adopt suitable measures to overcome the barriers and improve communication effectiveness. Some such measures are indicated below:

(i) *Clarify the ideas before communication:* The problem to be communicated to subordinates should be clear in all its perspective to the executive himself. The entire problem should be studied in depth, analysed and stated in such a manner that is clearly conveyed to subordinates.

(ii) *Communicate according to the needs of receiver:* The level of understanding of receiver should be crystal clear to the communicator. Manager should adjust his communication according to the education and understanding levels of subordinates.

(iii) *Consult others before communicating:* Before actually communicating the message, it is better to involve others in developing a plan for communication. Participation and involvement of subordinates may help to gain ready acceptance and willing cooperation of subordinates.

(iv) *Be aware of languages, tone and content of message:* The contents of the message, tone, language used, manner in which the message is to be communicated are the important aspects of effective communication. The language used should be understandable to the receiver and should not offend the sentiments of listeners. The message should be stimulating to evoke response from the listeners.

(v) *Convey things of help and value to listeners:* While conveying message to others, it is better to know the interests and needs of the people with whom you are communicating. If the message relates directly or indirectly to such interests and needs it certainly evokes response from communicatee.

(vi) *Ensure proper feedback:* The communicator may ensure the success of communication by asking questions regarding the message conveyed. The receiver of communication may also be encouraged to respond to communication. The communication process may be improved by the feedback received to make it more responsive.

(vii) *Communicate for present as well as future:* Generally, communication is needed to meet the existing commitments to maintain consistency, the communication should aim at future goals of the enterprise also.

(viii) *Follow up communications:* There should be regular follow up and review on the instructions given to subordinates. Such follow up measures help in removing hurdles if any in implementing the instructions.

(ix) *Be a good listener:* Manager should be a good listener. Patient and attentive listening solves half of the problems. Managers should also give indications of their interest in listening to their subordinates.

Key Terms

Directing | Supervision | Motives | Motivation | Incentives

Self actualisation | Egoistic needs | Leadership | Trait approach

Communication | Encoding | Decoding | Feedback

Semanticism | Formal communication

Informal communication | Profit sharing | Copartnership

Quality circles | Stock options

Summary

Directing is a complex managerial function consisting of all the activities that are designed to encourage subordinates to work effectively. It includes supervision, motivation, communication and leading. The principles which guide effective directing may be classified as principles related to the purpose of directing and principles related to direction process.

Supervision: It is an element of direction. It can be understood as a process as well as the functions performed by supervisor (a

position at operative level). Supervision is very important as it is closely linked to overseeing the work, guiding and ensuring that targets are met by workers and employees.

Motivation: Motivation is the process of stimulating people to action to accomplish desired goals of organisation. It is an internal feeling of an individual and leads to goal directed behaviour. Motivation is mainly based on needs of individuals. It helps individuals and groups in the organisation for improved performance.

Managers offer incentives to employees both financial and non financial. Financial incentives are monetary and may be in the form of salary, bonus, profit sharing, pension etc. Non financial incentives provide social and psychological satisfaction. These include status, promotion, responsibility, job enrichment, job recognition, job security, employee participation, delegation, empowerment etc.

One important theory of motivation is Maslow's Need Hierarchy theory. According to this theory, motivation to be provided depends on needs which are hierarchical in nature. The needs in this hierarchy have been classified as physiological needs, safety needs, social needs, egoistic needs and self-actualisation needs. It assumes that a satisfied need seldom motivates and only higher level need can motivate a person. This theory is relevant even today, as it focuses on needs which are basis for motivation.

Leadership: Leadership is most important factor in the success of an enterprise. It is the process of influencing people to strive willingly for group objectives. The qualities of a good leader have been researched by many experts. Some of the qualities of good leader include–courage, will power, judgement, knowledge, integrity, physical energy, faith, moral qualities, fairness, vitality, decisiveness, social skills etc. But all these qualities cannot be possessed by one individual nor always help in their success.

Communication: Communication refers to process of exchange of ideas between or among persons and create understanding. Communication process involves the elements of source, encoding, channel, receiver, decoding and feedback. In organisations, both formal and informal communications simultaneously takes place. Formal communications refers to all official communications in the form of orders, memos, appeals, notes, circulars, agenda, minutes etc. Apart from formal communications, informal or grapevine communications also exist. Informal communications are usually in the form of rumours, whispers etc. They are unofficial, spontaneous, unrecorded, spread very fast and usually distorted. A manager should learn to manage with informal communication also. In most of the organisations, several barriers may exist for effective communications. Some of these barriers include – semantic barriers, organisational barriers, language barriers, transmission barriers, psychological barriers and personal barriers. Managers should take appropriate measures to overcome these barriers and promote effective communication in the organisation.

Exercises

Multiple Choice

1. Which one of the following is not an element of direction?
   (a) Motivation (b) Communication
   (c) Delegation (d) Supervision
2. The motivation theory which classifies needs in hierarchical order is developed by
   (a) Fred Luthans (b) Scott
   (c) Abraham Maslow (d) Peter F. Drucker
3. Which of the following is a financial incentive?
   (a) Promotion (b) Stock Incentive
   (c) Job Security (d) Employee Participation
4. Which of the following is not an element of communication process?
   (a) Decoding (b) Communication
   (c) Channel (d) Receiver
5. Grapevine is
   (a) Formal communication
   (b) Barrier to communication
   (c) Lateral communication
   (d) Informal communication
6. Status comes under the following type of barriers
   (a) Semantic barrier (b) Organisational barrier
   (c) Non Semantic barrier (d) Psychological barrier
7. The software company promoted by Narayana Murthy is
   (a) Wipro (b) Infosys
   (c) Satyam (d) HCL

8. The highest level need in the need Hierarchy of Abraham Maslow:
   (a) Safety need (b) Belongingness need
   (c) Self actualisation need (d) Prestige need
9. The process of converting the message into communication symbols is known as-
   (a) Media (b) Encoding
   (c) Feedback (d) Decoding
10. The communication network in which all subordinates under a supervisor communicate through supervisor only is:
   (a) Single chain (b) Inverted V
   (c) Wheel (d) Free flow

Short Answer Type

1. Distinguish between leaders and managers.
2. Define Motivation
3. What is informal communication?
4. What are semantic barriers of communication?
5. Who is a supervisor?
6. What are the elements of directing?
7. Explain the process of motivation?
8. Explain different networks of grapevine communications?

Long Answer Type

1. Explain the principles of Directing?
2. Explain the qualities of a good leader? Do the qualities alone ensure leadership success?
3. Discuss Maslow's Need Hierarchy theory of motivation.
4. What are the common barriers to effective communication? Suggest measures to overcome them.
5. Explain different financial and non-financial incentives used to motivate employees of a company?

Application type

1. The workers always try to show their inability when any new work is given to them. They are always unwilling to take up any kind of work. Due to sudden rise in demand a firm wants to meet excess orders. The supervisor is finding it difficult to cope up with the situation. Suggest ways for the supervisor to handle the problem.

2. Workers of a factory often come to the Production Manager with the grievances. The production manager finds himself overburdened with so many tasks. Advise a way to relieve the production manager.
3. In an organisation employees always feel they are under stress. They take least initiative and fear to express their problems before the manager. What do you think is wrong with the manager ?
4. In an organisation all the employees take things easy and are free to approach anyone for minor queries and problems. This has resulted in everyone taking to each other and thus resulting in inefficiency in the office. It has also resulted in loss of secrecy and confidential information being leaked out. What system do you think the manager should adopt to improve communication.

Project Work

Project Work and Assignments

1. The teacher will select five students as a group and one student as a judge. Each student in the group prepares a talk on any topic about ten sentences. Each student shall present his talk while others listen carefully. Finally, the judge asks each person five questions from five presentations. Each successful answer carries two marks. This exercise helps to identify listening ability.
2. Conduct a survey on your classmates and ask them about their motives regarding the following:
   (i) Joining school
   (ii) Choosing course of study
   (ii) Buying a brand of pen
   (iv) Going to a movie
   (v) Viewing a TV channel/Programme

   List out the motives common to most students for each of the above.
3. Identify barriers of communication
   (i) Between you and your teacher
   (ii) Between you and your friend
   (iii) Between you and your brother/sister

   Suggest measures to overcome these barriers. Are they similar to what managers would do.

4. Meet 10 people for each of the following product they have recently purchased
   (i) Detergent soap
   (ii) Fairness cream
   (iii) Motor bike

   Ask them about their motives in buying the product/ brand. Identify the buying motives for each product and present it in the classroom.

Case Problem

Y limited is a bank functioning in India. It is planning to diversify into insurance business. Lately, the government of India has allowed the private sector to gain entry in the insurance business. Previously, it was the prerogative of LIC and GIC to do insurance business. But now with liberalisation of the economy and to make the field competitive other companies have been given licenses to start insurance business under the regulation of 'Insurance Regulatory and Development Authority'.
Y limited plans to recruit high quality employees and agents and exercise effective direction to capture a substantial part of life and non life insurance business.

Questions

1. Identify how the company can supervise its employees and agents effectively. What benefits will the company derive from effective supervision?
2. What financial and non-financial incentives can the company use for employees and agents separately to motivate them. What benefits will the company get from them?
3. How can the company ensure that higher order needs i.e., esteem and self-actualisation as specified by Abraham Maslow are met?
4. Identify the qualities of leadership in this line of business that the company managers must possess to motivate employees and agents.
5. Give a model of formal communication system that the company can follow. Identify the barriers in this model. How can they be removed?
6. How can informal communication help to supplement formal communication model given by you in answer to question 5?

CONTROLLING

8
CHAPTER

Damage Control at Sterling Courier

Sterling Courier Systems based in Hendon, Virginia is a provider of same-day-delivery services. Although Sterling may do everything right to meet its delivery commitments, it relies on commercial airlines to transport its parcels, and occasionally fails to meet its deadlines. Delays are usually a result of packages being misplaced in airlines' tracking systems. Such incidents are beyond Sterling's control. But from the customer's vantage point, the failure is Sterling's problem.

To control the damage created by such delays, Sterling had to take some corrective measures. For example, for several months in late 1990 and early 1991 several Sterling deliveries disappeared in transit. The packages turned up later, but the customers had already suffered financial losses. Yet because the packages were eventually recovered, neither insurance nor the airlines was liable. The decision for president Glenn Smoak was whether to compensate the customers for their losses or simply not to charge them for the shipments. Smoak concluded that not charging for the shipment was an inadequate response, given the suffered downtime. But paying the $30,000 in losses would push the then-five-year-old $5 million company into a loss for the quarter. Smoak's decision was to pay out the $30,000 in gratis service, the customer stayed, and Sterling continues to grow.

Source: Stoner, A.F. James, R. Edward Freeman and Daniel R. Gilbert, Jr., Management, Prentice-Hall of India Pvt. Ltd., 1998

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- Explain the meaning of controlling;
- State the importance of controlling;
- Describe the relationship between planning and controlling;
- Explain the steps in the process of controlling; and
- Describe the techniques of controlling.

The example of Sterling Courier brings out clearly how an adverse business situation may intelligently be controlled by a manager. It is quite clear from the example that a manager needs to take some sort of corrective action before any major damage is done to the business. Controlling function of management comes to the rescue of a manager here. It not only helps in keeping a track on the progress of activities but also ensures that activities conform to the standards set in advance so that organisational goals are achieved.

Meaning of Controlling

Controlling is one of the important functions of a manager. In order to seek planned results from the subordinates, a manager needs to exercise effective control over the activities of the subordinates. In other words, controlling means ensuring that activities in an organisation are performed as per the plans. Controlling also ensures that an organisation's resources are being used effectively and efficiently for the achievement of predetermined goals. Controlling is, thus, a goal-oriented function.

Controlling function of a manager is a pervasive function. It is a primary function of every manager. Managers at all levels of management- top, middle and lower-need to perform controlling functions to keep a control over activities in their areas. Moreover, controlling is as much required in an educational institution, military, hospital, and a club as in any business organisation.

Controlling should not be misunderstood as the last function of management. It is a function that brings back the management cycle back to the planning function. The controlling function finds out how far actual performance deviates from standards, analyses the causes of such deviations and attempts to take corrective actions based on the same. This process helps in formulation of future plans in the light of the problems that were identified and, thus, helps in better planning in the future periods. Thus, controlling only completes one cycle of management process and improves planning in the next cycle.

Importance of Controlling

Control is an indispensable function of management. Without control the best of plans can go awry. A good control system helps an organisation in the following ways:

(i) **Accomplishing organisational goals:** The controlling function measures progress towards the organisational goals and brings to light the deviations, if any, and indicates corrective action.

> Managerial Control implies the measurement of accomplishment against the standard and the correction of deviations to assure attainment of objectives according to plans.
>
> *Koontz and O' Donnel*

It, thus, guides the organisation and keeps it on the right track so that organisational goals might be achieved.

(ii) **Judging accuracy of standards:** A good control system enables management to verify whether the standards set are accurate and objective. An efficient control system keeps a careful check on the changes taking place in the organisation and in the environment and helps to review and revise the standards in light of such changes.

(iii) **Making efficient use of resources:** By exercising control, a manager seeks to reduce wastage and spoilage of resources. Each activity is performed in accordance with predetermined standards and norms. This ensures that resources are used in the most effective and efficient manner.

(iv) **Improving employee motivation:** A good control system ensures that employees know well in advance what they are expected to do and what are the standards of performance on the basis of which they will be appraised. It, thus, motivates them and helps them to give better performance.

(v) **Ensuring order and discipline:** Controlling creates an atmosphere of order and discipline in the organisation. It helps to minimise dishonest behaviour on the part of the employees by keeping a close check on their activities. The box explains how an import-export company was able to track dishonest employees by using computer monitoring as a part of their control system.

(vi) **Facilitating coordination in action:** Controlling provides direction to all activities and

Control Through Computer Monitoring

Managers at a New York City import-export company suspected that two employees were robbing it. Corporate Defense Strategies (CDS) of Maywood, New Jersey, advised the firm to install a software program that could secretly log every single stroke of the suspects' computer keys and send an encrypted e-mail report to CDS. Investigators revealed that the two employees were deleting orders from the corporate books after processing them, pocketing the revenues, and building their own company from within. The programme picked up on their plan to return to the office late one night to steal a large shipment of electronics. Police hid in the rafters of the firm's warehouse, and when the suspects entered, they were arrested. The pair was charged with embezzling $3 million over two and a half years, a sizable amount of revenue for a $25 million-a-year firm.

Source: Hellriegel Don, Susan E. Jackson and John W. Slocum Jr., Management: A Competency-based Approach, Thompson, 2002, chap.19, p.526 efforts for achieving organisational goals. Each department and employee is governed by pre-determined standards which are well coordinated with one another. This ensures that overall organisational objectives are accomplished.

Limitations of Controlling

Although controlling is an important function of management, it suffers from the following limitations.

(i) **Difficulty in setting quantitative standards:** Control system loses some of its effectiveness when standards cannot be defined in quantitative terms. This makes measurement of performance and their comparison with standards a difficult task. Employee morale, job satisfaction and human behaviour are such areas where this problem might arise.

(ii) **Little control on external factors:** Generally an enterprise cannot control external factors such as government policies, technological changes, competition etc.

(iii) **Resistance from employees:** Control is often resisted by employees. They see it as a restriction on their freedom. For instance, employees might object when they are kept under a strict watch with the help of Closed Circuit Televisions (CCTVs).

Remain level headed even when things go wrong

2015-16(21/01/2015)

(iv) **Costly affair:** Control is a costly affair as it involves a lot of expenditure, time and effort. A small enterprise cannot afford to install an expensive control system. It cannot justify the expenses involved. Managers must ensure that the costs of installing and operating a control system should not exceed the benefits derived from it.

The box on Control System at FedEx gives an overview of the control system used by FedEx and how it helped FedEx to increase its profits.

Relationship between Planning and Controlling

Planning and controlling are inseparable twins of management. A system of control presupposes the existence of certain standards. These standards of performance which serve as the basis of controlling are provided by planning. Once a plan becomes operational, controlling is necessary to monitor the progress, measure it, discover deviations and initiate corrective measures to ensure that events conform to plans. Thus, planning without controlling is meaningless. Similarly, controlling is blind without planning. If the standards are not set in advance, managers have nothing to control. When there is no plan, there is no basis of controlling.

Planning is clearly a prerequisite for controlling. It is utterly foolish to think that controlling could be accomplished without planning. Without planning there is no

Control System at FedEx

FedEx operates an $18 billion delivery system from its eight U.S. and seven international hubs. It operates more than 630 airplanes, 42,500 vehicles, and 44,400 drop-off locations. It delivers more than three million express packages to customers in more than 200 countries. Effective control was one of the key to FedEx's increased profits during the past decade.

An important part of that control system was the ability to track customers' parcels at each stage of collection, shipment and delivery. Also, at FedEx, its controls help identify which customers generate the greatest profits and which eventually end up costing the company. FedEx closes accounts that aren't profitable to serve, such as those in small, widely scattered locations.

The Internet has enabled FedEx to attract and hold new customers by providing them with crucial information as needed. Customers can log onto the Internet and follow the progress of their packages. By providing timely information about services and costs, along with parcel progress to its customers, FedEx has been able to expand rapidly its customer base. More than 2.5 million customers are connected electronically with FedEx.

Source: Hellriegel Don, Susan E. Jackson and John W. Slocum, Jr., Management: A Competency-based Approach, Thompson, 2002 predetermined understanding of the desired performance. Planning seeks consistent, integrated and articulated programmes while controlling seeks to compel events to conform to plans.

Planning is basically an intellectual process involving thinking, articulation and analysis to discover and prescribe an appropriate course of action for achieving objectives. Controlling, on the other hand, checks whether decisions have been translated into desired action. Planning is thus, prescriptive whereas, controlling is evaluative.

It is often said that planning is looking ahead while controlling is looking back. However, the statement is only partially correct. Plans are prepared for future and are based on forecasts about future conditions. Therefore, planning involves looking ahead and is called a forward-looking function. On the contrary, controlling is like a postmortem of past activities to find out deviations from the standards. In that sense, controlling is a backward-looking function. However, it should be understood that planning is guided by past experiences and the corrective action initiated by control function aims to improve future performance. Thus, planning and controlling are both backward-looking as well as a forward-looking function.

Thus, planning and controlling are interrelated and, in fact, reinforce each other in the sense that

1. Planning based on facts makes controlling easier and effective; and
2. Controlling improves future planning by providing information derived from past experience.

Controlling Process

Controlling is a systematic process involving the following steps.

1. Setting performance standards
2. Measurement of actual performance
3. Comparison of actual performance with standards
4. Analysing deviations
5. Taking corrective action

Step 1: *Setting Performance Standards:* The first step in the controlling process is setting up of performance standards. Standards are the criteria against which actual performance would be measured. Thus, standards serve as benchmarks towards which an organisation strives to work.

Standards can be set in both quantitative as well as qualitative terms. For instance, standards set in terms of cost to be incurred, revenue to be earned, product units to be produced and sold, time to be spent in performing a task, all represents quantitative standards. Sometimes standards may also be set in qualitative terms. Improving goodwill and motivation level of employees are examples of qualitative standards. The table in the next page gives a glimpse of standards used in different functional areas of business to gauge performance.

At the time of setting standards, a manager should try to set standards in precise quantitative terms as this would make their comparison with actual performance much easier. For instance, reduction of defects from 10 in every 1,000 pieces produced to 5 in every 1,000 pieces produced by the end of the quarter. However, whenever qualitative standards are set, an effort must be made to define them in a manner that would make their measurement easier. For instance, for improving customer satisfaction in a fast food chain having self-service, standards can be set in terms of time taken by a customer to wait for a table, time taken by him to place the order and time taken to collect the order.

It is important that standards should be flexible enough to be modified whenever required. Due to changes taking place in the internal and external business environment, standards may need some modification to be realistic in the changed business environment.

Step 2: *Measurement of Actual Performance:* Once performance standards are set, the next step is measurement of actual performance. Performance should be measured in an objective and reliable manner. There are several techniques for measurement of performance. These include personal observation, sample checking, performance reports, etc. As far as possible, performance should be measured in the same units in which standards are set as this would make their comparison easier.

It is generally believed that measurement should be done after the task is completed. However, wherever possible, measurement of work should be done during the performance. For instance, in case of assembling task, each part produced should be checked before assembling. Similarly, in a manufacturing plant, levels

Standards used in Functional Areas to Gauge Performance

Production	Marketing	Human Resource Management	Finance and Accounting
Quantity	Sales volume	Labour relations	Capital expenditures
Quality	Sales expense	Labour turnover	Inventories
Cost	Advertising expenditures	Labour absenteeism	Flow of capital
Individual job	Individual		Liquidity
Performance	Sales-person's performance		

of gas particles in the air could be continuously monitored for safety.

Measurement of performance of an employee may require preparation of performance report by his superior. Measurement of a company's performance may involve calculation of certain ratios like gross profit ratio, net profit ratio, return on investment, etc., at periodic intervals. Progress of work in certain operating areas like marketing may be measured by considering the number of units sold, increase in market share etc., whereas, efficiency of production may be measured by counting the number of pieces produced and number of defective pieces in a batch. In small organisations, each piece produced may be checked to ensure that it conforms to quality specifications laid down for the product. However, this might not be possible in a large organisation. Thus, in large organisations, certain pieces are checked at random for quality. This is known as sample checking.

Step 3: *Comparing Actual Performance with Standards:* This step involves comparison of actual performance with the standard. Such comparison will reveal the deviation between actual and desired results. Comparison becomes easier when standards are set in quantitative terms. For instance, performance of a worker in terms of units produced in a week can be easily measured against the standard output for the week.

Step 4: *Analysing Deviations:* Some deviation in performance can be expected in all activities. It is, therefore, important to determine the acceptable range of deviations. Also, deviations in key areas of business need to be attended more urgently as compared to deviations in certain insignificant areas. Critical point control and management by exception should be used by a manager in this regard.

1. *Critical Point Control:* It is neither economical nor easy to keep a check on each and every activity in an organisation. Control should, therefore, focus on key result areas (KRAs) which are critical to the success of an organisation. These KRAs are set as the critical points. If anything goes wrong at the critical points, the entire organisation suffers. For instance, in a manufacturing organisation, an increase of 5 per cent in the labour cost may be more troublesome than a 15 per cent increase in postal charges.
2. *Management by Exception:* Management by exception, which is often referred to as control by exception, is an important principle of management control based on the belief that an attempt to control everything results in controlling nothing. Thus, only significant deviations which go beyond the permissible limit

should be brought to the notice of management. Thus, if the plans lay down 2 per cent increase in labour cost as an acceptable range of deviation in a manufacturing organisation, only increase in labour cost beyond 2 per cent should be brought to the notice of the management. However, in case of major deviation from the standard (say, 5 per cent), the matter has to receive immediate action of management on a priority basis.

The box below highlights the advantages of critical point control and management by exception.

After identifying the deviations that demand managerial attention, these deviations need to be analysed for their causes. Deviations may have multiple causes for their origin. These include unrealistic standards, defective process, inadequacy of resources, structural drawbacks, organisational constraints and environmental factors beyond the control of the organisation. It is necessary to identify the exact cause(s) of deviations, failing which, an appropriate corrective action might not be possible. The deviations and their causes are then reported and corrective action taken at appropriate level.

Step 5: *Taking Corrective Action:* The final step in the controlling process is taking corrective action. No corrective action is required when the deviations are within acceptable limits. However, when the deviations go beyond the acceptable range, especially in the important areas, it demands immediate managerial attention so that deviations do not occur again and standards are accomplished.

Corrective action might involve training of employees if the production target could not be met. Similarly, if an important project is running behind schedule, corrective action might involve assigning of additional workers and equipment to the project and permission for overtime work. In

Advantages of Critical Point Control and Management by Exception

When a manager sets critical points and focuses attention on significant deviations which cross the permissible limit, the following advantages accrue:

1. It saves the time and efforts of managers as they deal with only significant deviations.
2. It focuses managerial attention on important areas. Thus, there is better utilisation of managerial talent.
3. The routine problems are left to the subordinates. Management by exception, thus, facilitates delegation of authority and increases morale of the employees.
4. It identifies critical problems which need timely action to keep the organisation in right track.

Remedial Plan of Action:
Analysing deviations

case the deviation cannot be corrected through managerial action, the standards may have to be revised. The table below cites some of the causes of deviations and the respective corrective action that might be taken by a manager.

The information in the box in next page gives an account of how Saco Defense was able to control a crisis situation.

Some examples of Corrective Action

Causes of deviation	Corrective action to be taken
1. Defective material	Change the quality specification for the material used
2. Defective machinery	Repair the existing machine or replace the machine if it cannot be repaired
3. Obsolete machinery	Undertake technological upgradation of machinery
4. Defective process	Modify the existing process
5. Defective physical conditions of work	Improve the physical conditions of work

How Saco Defense Controlled the Situation?

At Saco Defense, lack of quality had created a crisis. When the government shut it down because it wasn't meeting quality standards, Saco brought back a TQM programme that had restored quality, increased production, and decreased costs. Based in Saco, Maine, the 178-year-old defense company was unable to adhere to the U.S. Navy's quality standards. Although Saco's weapons worked well, the government questioned the company's quality practices and policies. For example, if an employee discovered a defective bolt near the completion of an assembly process, the operator would replace the bolt but not document the problem. The presence of one defective bolt might mean that others from the same supplier or batch were also bad but were going undetected. Without follow-up, the underlying materials problem would not be identified and resolved.

To solve these problems Saco Defense went through an organisational transformation. The key elements were: (1) empowering employees by giving them the responsibility and accountability for their performance, including the authority to halt production to correct problems; (2) forming work cells, that is, small businesses within the company that manage their production with limited supervision; and (3) reducing the workforce from 760 to about 450 employees and eliminating several layers of management. In addition, ongoing improvement projects at the company range from reducing cycle time and product cost to implementing programmes for skill integration. Productivity has increased, turnover is down, and the company plans to expand its international business.

Source: Stoner, A.F. James, R. Edward Freeman and Daniel R. Gilbert, Jr., Management, Prentice-Hall of India Pvt. Ltd., 1998
(Ref: Joyce E. Santora, 'A Quality Program Transforms Saco Defense', Personnel Journal, May 1993)

Techniques of Managerial Control

The various techniques of managerial control may be classified into two broad categories: traditional techniques, and modern techniques.

Traditional Techniques

Traditional techniques are those which have been used by the companies for a long time now. However, these techniques have not become obsolete and are still being used by companies. These include:

(a) Personal observation
(b) Statistical reports
(c) Breakeven analysis
(d) Budgetary control

Modern Techniques

Modern techniques of controlling are those which are of recent origin and are comparatively new in management literature. These techniques provide a refreshingly new thinking on the ways in which various aspects of an organisation can be controlled. These include:

(a) Return on investment
(b) Ratio analysis
(c) Responsibility accounting
(d) Management audit
(e) PERT and CPM
(f) Management information system

Traditional Techniques

Personal Observation

This is the most traditional method of control. Personal observation enables the manager to collect first hand information. It also creates a psychological pressure on the employees to perform well as they are aware that they are being observed personally on their job. However, it is a very time-consuming exercise and cannot effectively be used in all kinds of jobs.

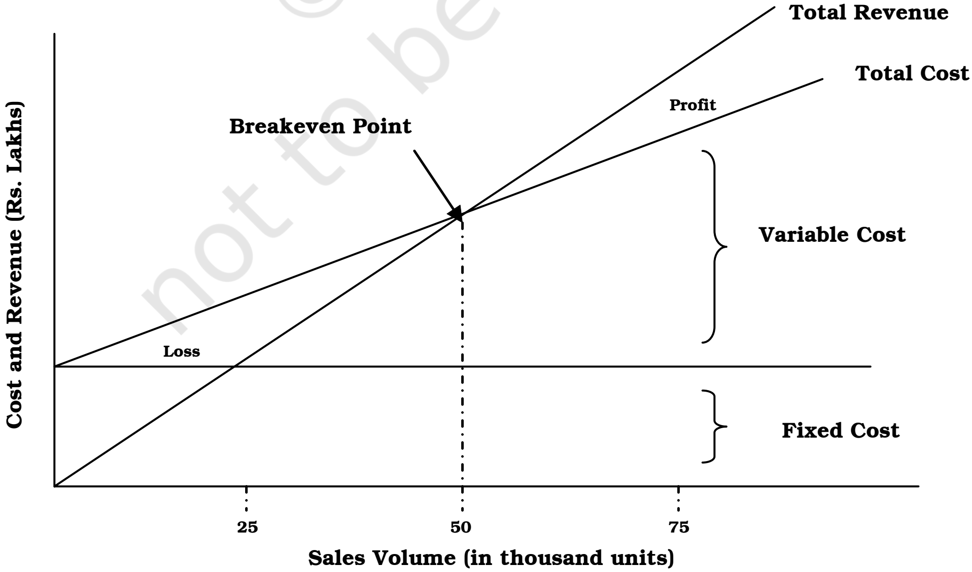
Statistical Reports

Statistical analysis in the form of averages, percentages, ratios, correlation, etc., present useful information to the managers regarding performance of the organisation in various areas. Such information when presented in the form of charts, graphs, tables, etc., enables the managers to read them more easily and allow a comparison to be made with performance in previous periods and also with the benchmarks.

Breakeven Analysis

Breakeven analysis is a technique used by managers to study the relationship between costs, volume and profits. It determines the probable profit and losses at different levels of activity. The sales volume at which

Breakeven Chart



there is no profit, no loss is known as breakeven point. It is a useful technique for the managers as it helps in estimating profits at different levels of activities.

The figure 1 shows breakeven chart of a firm. Breakeven point is determined by the intersection of Total Revenue and Total Cost curves. The figure shows that the firm will break even at 50,000 units of output. At this point, there is no profit no loss. It is beyond this point that the firm will start earning profits.

Breakeven point can be calculated with the help of the following formula:

$$\text{Breakeven Point} = \frac{\text{Fixed Costs}}{\text{Selling price per unit} - \text{Variable cost per unit}}$$

Breakeven analysis helps a firm in keeping a close check over its variable costs and determines the level of activity at which the firm can earn its target profit.

Budgetary Control

Budgetary control is a technique of managerial control in which all operations are planned in advance in the form of budgets and actual results are compared with budgetary standards. This comparison reveals the necessary actions to be taken so that organisational objectives are accomplished.

A budget is a quantitative statement for a definite future period of time for the purpose of obtaining a given objective. It is also a statement which reflects the policy of that particular period. It will contain figures of forecasts both in terms of time and quantities. The box shows the most common types of budgets used by an organisation.

Budgeting offers the following advantages:

Types of Budgets

- **Sales Budget**: A statement of what an organisation expects to sell in terms of quantity as well as value
- **Production Budget:** A statement of what an organisation plans to produce in the budgeted period
- **Material Budget:** A statement of estimated quantity and cost of materials required for production
- **Cash Budget:** Anticipated cash inflows and outflows for the budgeted period
- **Capital Budget:** Estimated spending on major long-term assets like new factory or major equipment
- **Research and Development Budget:** Estimated spending for the development or refinement of products and processes

1. Budgeting focuses on specific and time-bound targets and thus, helps in attainment of organisational objectives.
2. Budgeting is a source of motivation to the employees who know the standards against which their performance will be appraised and thus, enables them to perform better.
3. Budgeting helps in optimum utilisation of resources by allocating them according to the requirements of different departments.
4. Budgeting is also used for achieving coordination among different departments of an organisation and highlights the interdependence between them. For instance, sales budget cannot be prepared without knowing production programmes and schedules.
5. It facilitates management by exception by stressing on those operations which deviate from budgeted standards in a significant way.

However, the effectiveness of budgeting depends on how accurately estimates have been made about future. Flexible budgets should be prepared which can be adopted if forecasts about future turn out to be different, especially in the face of changing environmental forces. Managers must remember that budgeting should not be viewed as an end but a means to achieve organisational objectives.

Modern Techniques

Return on Investment

Return on Investment (RoI) is a useful technique which provides the basic yardstick for measuring whether or not invested capital has been used effectively for generating reasonable amount of return. RoI can be used to measure overall performance of an organisation or of its individual departments or divisions. It can be calculated as under.

$$\text{RoI} = \frac{\text{Net Income}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Total Investment}}$$

Net Income before or after tax may be used for making comparisons. Total investment includes both working as well as fixed capital invested in business. According to this technique, RoI can be increased either by increasing sales volume proportionately more than total investment or by reducing total investment without having any reductions in sales volume.

RoI provides top management an effective means of control for measuring and comparing performance of different departments. It also permits departmental managers to find out the problem which affects RoI in an adverse manner.

Ratio Analysis

Ratio Analysis refers to analysis of financial statements through computation of ratios. The most commonly used ratios used by organisations can be classified into the following categories:

1. *Liquidity Ratios:* Liquidity ratios are calculated to determine short-term solvency of business. Analysis of current position of liquid funds determines the ability of the business to pay the amount due to its stakeholders.
2. *Solvency Ratios:* Ratios which are calculated to determine the long-term solvency of business are known as solvency ratios. Thus, these ratios determine the ability of a business to service its indebtedness.
3. *Profitability Ratios:* These ratios are calculated to analyse the profitability position of a business. Such ratios involve analysis of profits in relation to sales or funds or capital employed.
4. *Turnover Ratios:* Turnover ratios are calculated to determine the efficiency of operations based on effective utilisation of resources. Higher turnover means better utilisation of resources.

The table given below gives examples of some ratios commonly used by managers.

Responsibility Accounting

Responsibility accounting is a system of accounting in which different sections, divisions and departments of an organisation are set up as 'Responsibility Centres'. The head of the centre is responsible for achieving the target set for his centre.

Responsibility centres may be of the following types:

1. **Cost Centre:** A cost or expense centre is a segment of an organisation in which managers are held responsible for the cost

Examples of Commonly used Ratios

Type of Ratio	Examples
Liquidity	Current Ratio Quick Ratio
Solvency	Debt-Equity Ratio Proprietary Ratio Interest Coverage Ratio
Profitability	Gross Profit Ratio Net Profit Ratio Return on Capital Employed
Turnover	Inventory Turnover Ratio Stock Turnover Ratio Debtors Turnover Ratio

incurred in the centre but not for the revenues. For example, in a manufacturing organisation, production department is classified as cost centre.

2. **Revenue Centre:** A revenue centre is a segment of an organisation which is primarily responsible for generating revenue. For example, marketing department of an organisation may be classified as a revenue center.
3. **Profit Centre:** A profit centre is a segment of an organisation whose manager is responsible for both revenues and costs. For example, repair and maintenance department of an organisation may be treated as a profit center if it is allowed to bill other production departments for the services provided to them.
4. **Investment Centre:** An investment centre is responsible not only for profits but also for investments made in the centre in the form of assets. The investment made in each centre is separately ascertained and return on investment is used as a basis for judging the performance of the centre.

Management Audit

Management audit refers to systematic appraisal of the overall performance of the management of an organisation. The purpose is to review the efficiency and effectiveness of management and to improve its performance in future periods. It is helpful in identifying the deficiencies in the performance of management functions. Thus, management audit may be defined as evaluation of the functioning, performance and effectiveness of management of an organisation.

The main advantages of management audit are as follows.

1. It helps to locate present and potential deficiencies in the performance of management functions.
2. It helps to improve the control system of an organisation by continuously monitoring the performance of management.
3. It improves coordination in the functioning of various departments so that they work together effectively towards the achievement of organisational objectives.
4. It ensures updating of existing managerial policies and strategies in the light of environmental changes.

Conducting management audit may sometimes pose a problem as there are no standard techniques of management audit. Also, management audit is not compulsory under any law. Enlightened managers, however, understand its usefulness in improving overall performance of the organisation.

PERT and CPM

PERT (Programme Evaluation and Review Technique) and CPM (Critical

Path Method) are important network techniques useful in planning and controlling. These techniques are especially useful for planning, scheduling and implementing time bound projects involving performance of a variety of complex, diverse and interrelated activities. These techniques deals with time scheduling and resource allocation for these activities and aims at effective execution of projects within given time schedule and structure of costs.

The steps involved in using PERT/ CPM are as follows:

1. The project is divided into a number of clearly identifiable activities which are then arranged in a logical sequence.
2. A network diagram is prepared to show the sequence of activities, the starting point and the termination point of the project.
3. Time estimates are prepared for each activity. PERT requires the preparation of three time estimates – optimistic (or shortest time), pessimistic (or longest time) and most likely time. In CPM only one time estimate is prepared. In addition, CPM also requires making cost estimates for completion of project.
4. The longest path in the network is identified as the critical path. It represents the sequence of those activities which are important for timely completion of the project and where no delays can be allowed without delaying the entire project.
5. If required, the plan is modified so that execution and timely completion of project is under control.

PERT and CPM are used extensively in areas like ship-building, construction projects, aircraft manufacture, etc.

Management Information System

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

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

MIS offers the following advantages to the managers:

1. It facilitates collection, management and dissemination of information at different levels of management and across different departments of the organisation.

2. It supports planning, decision-making and controlling at all levels.
3. It improves the quality of information with which a manager works.
4. It ensures cost effectiveness in managing information.
5. It reduces information overload on the managers as only relevant information is provided to them.

Key Terms

Controlling | Critical point control | Management by exception

Breakeven analysis | Budgetary control | Return on investment

Ratio analysis | Responsibility accounting | Management audit

PERT and CPM | Management | Information system

Summary

- Controlling is the process of ensuring that actual activities conform to planned activities.
- The importance of managerial control lies in the fact that it helps in accomplishing organisational goals. Controlling also helps in judging accuracy of standards, ensuring efficient utilization of resources, boosting employee morale, creating an atmosphere of order and discipline in the organisation and coordinating different activities so that they all work together in one direction to meet targets.
- Controlling suffers from certain limitations also. An organisation has no control over external factors. The control system of an organisation may face resistance from its employees. Sometimes controlling turns out to be a costly affair, especially in case of small organisations. Moreover, it is not always possible for the management to set quantitative standards of performance in the absence of which controlling exercise loses some of its effectiveness.
- The process of control involves setting performance standards, measurement of actual performance, comparison of actual performance with standards, analysis of deviations and taking corrective action.

- Planning and controlling are inseparable twins of management. Planning initiates the process of management and controlling completes the process. Plans are the basis of control and without control the best laid plans may go astray.
- Personal observation, statistical reports, breakeven analysis and budgetary control are traditional techniques of managerial control.
- Return on investment, ratio analysis, responsibility accounting, management audit, PERT and CPM and Management Information System are modern techniques of managerial control.

Exercises

Multiple Choice

For the following, choose the right answer.

1. An efficient control system helps to
   (a) Accomplishes organisational objectives
   (b) Boosts employee morale
   (c) Judges accuracy of standards
   (d) All of the above
2. Controlling function of an organisation is
   (a) Forward looking
   (b) Backward looking
   (c) Forward as well as backward looking
   (d) None of the above
3. Management audit is a technique to keep a check on the performance of
   (a) Company
   (b) Management of the company
   (c) Shareholders
   (d) Customers
4. Budgetary control requires the preparation of
   (a) Training schedule
   (b) Budgets
   (c) Network diagram
   (d) Responsibility centres
5. Which of the following is not applicable to responsibility accounting
   (a) Investment centre
   (b) Accounting centre
   (c) Profit centre
   (d) Cost centre

Short Answer Type

1. Explain the meaning of controlling.
2. 'Planning is looking ahead and controlling is looking back.' Comment.
3. 'An effort to control everything may end up in controlling nothing.' Explain.
4. Write a short note on budgetary control as a technique of managerial control.
5. Explain how management audit serves as an effective technique of controlling.

Long Answer Type

1. Explain the various steps involved in the process of control.
2. Explain the techniques of managerial control.
3. Explain the importance of controlling in an organisation. What are the problems faced by the organisation in implementing an effective control system?
4. Discuss the relationship between planning and controlling.

Application Type

Following are some behaviours that you and others might engage in on the job. For each item, choose the behaviour that management must keep a check to ensure an efficient control system.

1. Biased performance appraisals
2. Using company's supplies for personal use
3. Asking a person to violate company's rules
4. Calling office to take a day off when one is sick
5. Overlooking boss's error to prove loyalty
6. Claiming credit for someone else's work
7. Reporting a violation on noticing it
8. Falsifying quality reports
9. Taking longer than necessary to do the job
10. Setting standards in consultation with workers

You are also required to suggest the management how the undesirable behaviour can be controlled.

Case Problem

A company 'M' limited is manufacturing mobile phones both for domestic Indian market as well as for export. It had enjoyed a substantial market share and also had a loyal customer following. But lately it has been experiencing problems because its targets have not been met with regard to sales and customer satisfaction. Also mobile market in India has grown tremendously and new players have come with better technology and pricing. This is causing problems for the company. It is planning to revamp its controlling system and take other steps necessary to rectify the problems it is facing.

Questions

1. Identify the benefits the company will derive from a good control system.
2. How can the company relate its planning with control in this line of business to ensure that its plans are actually implemented and targets attained.
3. Give the steps in the control process that the company should follow to remove the problems it is facing.
4. What techniques of control can the company use?

   In all the answers keep in mind the sector of business the company is in.

CHAPTER 9

FINANCIAL MANAGEMENT

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- explain the meaning of business finance;
- describe financial management;
- explain the role of financial management in our enterprise;
- discuss objectives of financial management and how they could be achieved;
- explain the meaning and importance of financial planning;
- state the meaning of capital structure;
- analyse the factors affecting the choice of an appropriate capital structure;
- state meaning of fixed capital and working capital; and
- analyse the factors affecting the requirement of fixed and working capital.

TATA STEEL ACQUIRES CORUS

Tata Steel, the biggest steel producer in the Indian private sector has acquired Corus, (formerly known as British Steel) in a deal worth $8.6 billion. This makes Tata Steel the fifth largest steel producer in the world. A financial decision of this magnitude has significant implicitness for both Tata Steel and Corus as well as their employees and shareholders. To mention some of them:

- Tata Steel will become the fifth largest producer of steel in the world.
- Tata Steel will raise a debt of over $ 8 billion to finance the transaction. The deal will be paid for by Tata Steel UK, a special purpose vehicle (SPV) set up for the purpose. This SPV will get funds from Tata Steel routed through a Singapore subsidiary. Another company of the Tata group, Tata Sons Ltd., will invest $ 1 billion dollars for preference shares along with Tata Steel which will invest an equal amount.
- Tata Steel, the acquirer company, shall have to arrange about 36,500 crores of rupees to finance the take-over.
- Tata Steel will have to raise this amount through debt or equity or a combination of both. Some amount may come from internal accruals also. This financing decision will affect the capital structure of Tata Steel.
- Tata Steel hopes to increase the production to 40 million tonnes and revenue to 32 billion US dollars by 2012.

- It may affect the competitiveness of Tata Steel because the cost of production of steel in all probability, will change.
- The dividend paying capacity of Tata Steel may be affected because of this huge cash outflow and because of a significantly higher debt which would need to be serviced before paying any dividends to shareholders.
- The degree of risk shall also be affected. Needless to emphasise, decisions like this affect the future of the organisation. These decisions are almost irrevocable after they have been formalised.

Source: The Economic Times

Introduction

In the above case, these decisions require careful financial planning, an understanding of the resultant capital structure and the riskiness and profitability of the enterprise. All these have a bearing on shareholders as well as employees. They require an understanding of business finance, major financial decision areas, financial risk, and working capital requirements of the business. Finance, as we all know, is essential for running a business. Success of business depends on how well finance is invested in assets and operations and how timely and cheaply the finances are arranged, from outside or from within the business.

Meaning of Business Finance

Money required for carrying out business activities is called business finance. Almost all business activities require some finance. Finance is needed to establish a business, to run it, to modernise it, to expand, or diversify it. It is required for buying a variety of assets, which may be tangible like machinery, factories, buildings, offices; or intangible such as trademarks, patents, technical expertise, etc. Also, finance is central to running the day-to-day operations of business, like buying material, paying bills, salaries, collecting cash from customers, etc. needed at every stage in the life of a business entity. Availability of adequate finance is, thus, very crucial for the survival and growth of a business.

Financial Management

All finance comes at some cost. It is quite imperative that it needs to be carefully managed. Financial Management is concerned with optimal procurement as well as the usage of finance. For optimal procurement, different available sources of finance are identified and compared in terms of their costs and associated risks. Similarly, the finance so procured needs to be invested in a manner that the returns from the investment exceed the cost at which procurement has taken place. Financial Management aims at reducing the cost of funds procured, keeping the risk under control and achieving effective deployment of such funds. It also aims at ensuring availability of enough funds whenever required as well as avoiding idle finance. Needless to emphasise, the future of a business depends a great deal on the quality of its financial management.

Importance: The role of financial management cannot be over-emphasised, since it has a direct bearing on the financial health of a business. The financial statements, such as Balance Sheet and Profit and Loss Account, reflect a firm's financial position and its financial health. Almost all items in the financial statements of a business are affected directly or indirectly through some financial management decisions. Some prominent examples of the aspects being affected could be as under:

(i) *The size* and *the composition of fixed assets of the business:* For example, a capital budgeting decision to invest a sum of Rs. 100 crores in fixed assets would raise the size of fixed assets block by this amount.

(ii) *The quantum of current assets and its break-up into cash, inventory and receivables:* With an increase in the investment in fixed assets, there is a commensurate increase in the working capital requirement. The quantum of current assets is also influenced by financial management decisions. In addition, decisions about credit and inventory management affect the amount of debtors and inventory which in turn affect the total current assets as well as their composition.

(iii) *The amount of long-term and short-term funds to be used:* Financial management, among others, involves decision about the proportion of long-term and short-term funds. An organisation wanting to have more liquid assets would raise relatively more amount on a long-term basis. There is a choice between liquidity and profitability. The underlying assumption here is that current liabilities cost less than long term liabilities.

(iv) *Break-up of long-term financing into debt, equity etc:* Of the total long-term finance, the proportions to be raised by way of debt and/or equity is also a financial management decision. The amounts of debt, equity share capital, preference share capital are affected by the financing decision, which is a part of financing management.

(v) *All items in the Profit and Loss Account, e.g., Interest, Expense, Depreciation, etc. :* Higher amount of debt means higher interest expense in future. Similarly, use of higher equity may entail higher payment of dividends. Similarly, an expansion of business which is a result of capital budgeting decision is likely to affect virtually all items in the profit and loss account of the business.

It can, thus, be stated that the financial statements of a business are largely determined by financial management decisions taken earlier. Similarly, the future financial statements would depend upon past as well as current financial decisions. Thus, the overall financial health of a business is determined by the quality of its financial management. Good financial management aims at mobilisation of financial resources at a lower cost and deployment of these in most lucrative activities.

Objectives

The primary aim of financial management is to maximise shareholders' wealth, which is referred to as the wealth-maximisation concept. The market price of a company's shares is linked to the three basic financial decisions which you will study a little later. This is because a company funds belong to the shareholders and the manner in which they are invested and the return earned by them determines their market value and price. It means maximisation of the market value of equity shares. The market price of equity share increases, if the benefit from a decision exceeds the cost involved. All financial decisions aim at ensuring that each decision is efficient and adds some value. Such value additions tend to increase the market price of shares. Therefore, those financial decisions are taken which will ultimately prove gainful from the point of view of the shareholders. The shareholders gain if the value of shares in the market increases. Those decisions which result in decline in the share price are poor financial decisions. Thus, we can say, the objective of financial management is to maximise the current price of equity shares of the company or to maximise the wealth of owners of the company, that is, the shareholders.

Therefore, when a decision is taken about investment in a new machine, the aim of financial management is to ensure that benefits from the investment exceed the cost so that some value addition takes place. Similarly, when finance is procured, the aim is to reduce the cost so that the value addition is even higher.

In fact, in all financial decisions, major or minor, the ultimate objective that guides the decision-maker is that some value addition should take place. All those avenues of investment, modes of financing, ways of handling various components of working capital must be identified which will ultimately lead to an increase in the price of equity share. It can happen through efficient decision-making. Decision-making is efficient if, out of the various available alternatives, the best is selected.

Financial Decisions

Financial management is concerned with the solution of three major issues relating to the financial operations of a firm corresponding to the three questions of investment, financing and divident decision. In a financial context, it means the selection of best financing alternative or best investment alternative. The finance function, therefore, is concerned with three broad decisions which are explained below:

Investment Decision

A firm's resources are scarce in comparison to the uses to which they can be put. A firm, therefore, has to choose where to invest these resources, so that they are able to earn the highest possible return for their investors. The investment decision, therefore, relates to how the firm's funds are invested in different assets.

Investment decision can be long-term or short-term. A long-term investment decision is also called a *Capital Budgeting decision*. It involves committing the finance on a long-term basis. For example, making investment in a new machine to replace an existing one or acquiring a new fixed asset or opening a new branch, etc. These decisions are very crucial for any business since they affect its earning capacity in the long run. The size of assets, profitability and competitiveness are all affected by capital budgeting decisions. Moreover, these decisions normally involve huge amounts of investment and are irreversible except at a huge cost. Therefore, once made, it is often almost impossible for a business to wriggle out of such decisions. Therefore, they need to be taken with utmost care. These

Wealth Maximisation Concept

decisions must be taken by those who understand them comprehensively. A bad capital budgeting decision normally has the capacity to severely damage the financial fortune of a business. *Short-term investment decisions* (also called working capital decisions) are concerned with the decisions about the levels of cash, inventory and receivables. These decisions affect the day-to-day working of a business. These affect the liquidity as well as profitability of a business. Efficient cash management, inventory management and receivables management are essential ingredients of sound working capital management.

Factors affecting Capital Budgeting Decision

A number of projects are often available to a business to invest in. But each project has to be evaluated carefully and, depending upon the returns, a particular project is either selected or rejected. If there is only one project, its viability in terms of the rate of return, viz., investment and its comparability with the industry's average is seen. There are certain factors which affect capital budgeting decisions.

(a) *Cash flows of the project:* When a company takes an investment decision involving huge amount it expects to generate some cash flows over a period. These cash flows are in the form of a series of cash receipts and payments over the life of an investment. The amount of these cash flows should be carefully analysed before considering a capital budgeting decision.

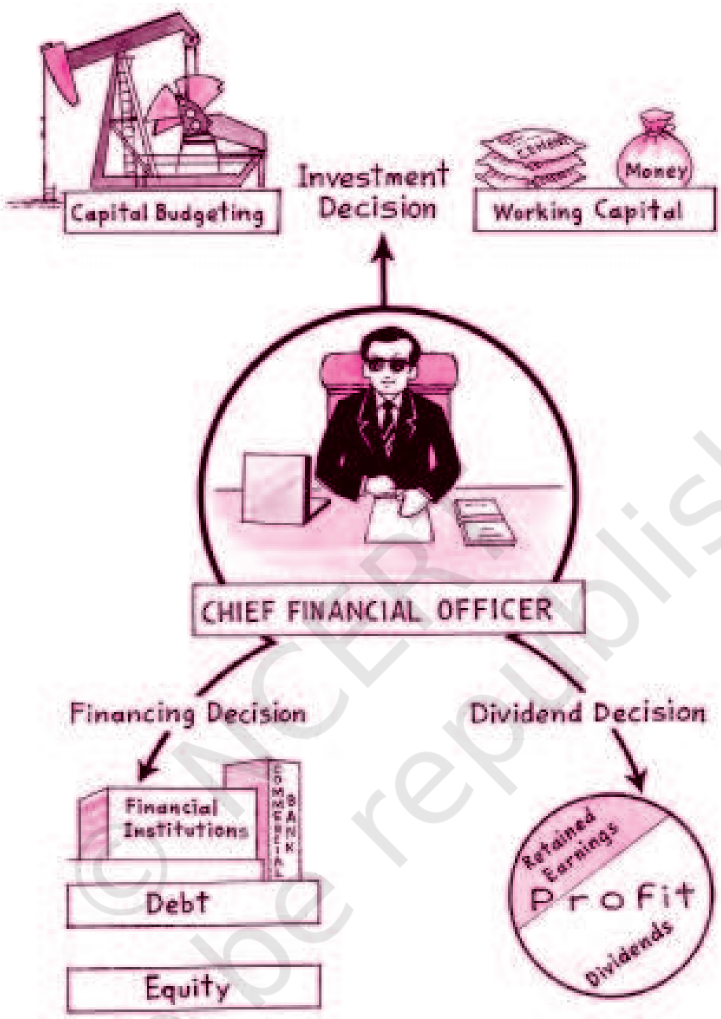
(b) *The rate of return:* The most important criterion is the rate of return of the project. These calculations are based on the expected returns from each proposal and the assessment of the risk involved. Suppose, there are two projects, A and B (with the same risk involved), with a rate of return of 10 per cent and 12 per cent, respectively, then under normal circumstance, project B should be selected.

(c) *The investment criteria involved:* The decision to invest in a particular project involves a number of calculations regarding the amount of investment, interest rate, cash flows and rate of return. There are different techniques to evaluate investment proposals which are known as capital budgeting techniques. These techniques are applied to each proposal before selecting a particular project.

Financing Decision

This decision is about the quantum of finance to be raised from various long-term sources. Short-term sources are studied under the 'working capital management'.

It involves identification of various available sources. The main sources of funds for a firm are shareholders' funds and borrowed funds. The shareholders' funds refer to the equity capital and the retained earnings. Borrowed funds refer to the finance raised through debentures or other forms of debt. A firm has to decide the proportion of funds to be raised from either sources, based on their basic characteristics. Interest on borrowed funds have to be paid regardless of whether or not a firm has earned a profit. Likewise, the borrowed funds have to be repaid at a fixed time. The risk of default on payment is known as financial risk which has to be considered by a firm likely to have insufficient shareholders to make these fixed payments. Shareholders' funds, on the other hand, involve no commitment regarding the payment of returns or the repayment of capital. A firm, therefore, needs to have a judicious mix of both debt and equity in making financing decisions, which may be debt, equity, preference share capital, and retained earnings.



Financial Decisions

The cost of each type of finance has to be estimated. Some sources may be cheaper than others. For example, debt is considered to be the cheapest of all the sources, tax deductibility of interest makes it still cheaper. Associated risk is also different for each source, e.g., it is necessary to pay interest on debt and redeem the principal amount on maturity. There is no such compulsion to pay any dividend on equity shares. Thus, there is some amount of financial risk in debt financing. The overall financial risk depends upon the proportion of debt in the total capital. The fund raising exercise also costs something. This cost is called floatation cost. It also must be considered while evaluating different sources. Financing decision is, thus, concerned with the decisions about how much to be raised from which source. This decision determines the overall cost of capital and the financial risk of the enterprise.

Factors Affecting Financing Decisions

The financing decisions are affected by various factors. Important among them are as follows:

(a) *Cost:* The cost of raising funds through different sources are different. A prudent financial manager would normally opt for a source which is the cheapest.

(b) *Risk:* The risk associated with each of the sources is different.

(c) *Floatation Costs:* Higher the floatation cost, less attractive the source.

(d) *Cash Flow Position of the Company:* A stronger cash flow position may make debt financing more viable than funding through equity.

(e) *Fixed Operating Costs:* If a business has high fixed operating costs (e.g., building rent, Insurance premium, Salaries, etc.), It must reduce fixed financing costs. Hence, lower debt financing is better. Similarly, if fixed operating cost is less, more of debt financing may be preferred.

(f) *Control Considerations:* Issues of more equity may lead to dilution of management's control over the business. Debt financing has no such implication. Companies afraid of a takeover bid would prefer debt to equity.

India Inc. Issues Bonus Shares and Dividends

Corporate India has opened its purse strings to shareholders with interim dividends and bonus shares. At least 60 companies have declared interim dividend or announced plans to do so in the first three weeks of January. In addition, around 12 companies have announced bonus share issues this month, about three times more than January 2006.

There are range of things that a company can do for maximising shareholder value and dividend is the most direct and simple form of it. Ideally companies need to balance it up between paying cash and building value of the stock for total shareholder returns.

This trend of dividends and bonuses is in synchronisation with the good profits being posted by companies. It's a way of rewarding shareholders.

A number of companies have also announced plans of bonus shares for their shareholders. Most of the companies who have already declared bonus issues or announced that they would be taking it up in their next board meeting are small or mid-sized companies.

Source: The Economic Times

(g) *State of Capital Market:* Health of the capital market may also affect the choice of source of fund. During the period when stock market is rising, more people invest in equity. However, depressed capital market may make issue of equity shares difficult for any company.

Dividend Decision

The third important decision that every financial manager has to take relates to the distribution of dividend. Dividend is that portion of profit which is distributed to shareholders. The decision involved here is how much of the profit earned by company (after paying tax) is to be distributed to the shareholders and how much of it should be retained in the business. While the dividend constitutes the current income re-investment as retained earning increases the firm's future earning capacity. The extent of retained earnings also influences the financing decision of the firm. Since the firm does not require funds to the extent of re-invested retained earnings, the decision regarding dividend should be taken keeping in view the overall objective of maximising shareholder's wealth.

Factors Affecting Dividend Decision

How much of the profits earned by a company will be distributed as profit and how much will be retained in the business is affected by many factors. Some of the important factors are discussed as follows:

(a) *Amount of Earnings:* Dividends are paid out of current and past earning. Therefore, earnings is a major determinant of the decision about dividend.

(b) *Stability Earnings:* Other things remaining the same, a company having stable earning is in a better position to declare higher dividends. As against this, a company having unstable earnings is likely to pay smaller dividend.

(c) *Stability of Dividends:* Companies generally follow a policy of stabilising dividend per share. The increase in dividends is generally made when there is confidence that their earning potential has gone up and not just the earnings of the current year. In other words, dividend per share is not altered if the change in earnings is small or seen to be temporary in nature.

(d) *Growth Opportunities:* Companies having good growth opportunities retain more money out of their earnings so as to finance the required investment. The dividend in growth companies is, therefore, smaller, than that in the non–growth companies.

(e) *Cash Flow Position:* The payment of dividend involves an outflow of cash. A company may be earning profit but may be short on cash. Availability of enough cash in the company is necessary for declaration of dividend.

(f) Shareholders' Preference: While declaring dividends, managements must keep in mind the preferences of the shareholders in this regard. If the shareholders in general desire that at least a certain amount is paid as dividend, the companies are likely to declare the same. There are always some shareholders who depend upon a regular income from their investments.

(g) Taxation Policy: The choice between the payment of dividend and retaining the earnings is, to some extent, affected by the difference in the tax treatment of dividends and capital gains. If tax on dividend is higher, it is better to pay less by way of dividends. As compared to this, higher dividends may be declared if tax rates are relatively lower. Though the dividends are free of tax in the hands of shareholders, a dividend distribution tax is levied on companies. Thus, under the present tax policy, shareholders are likely to prefer higher dividends.

(h) Stock Market Reaction: Investors, in general, view an increase in dividend as a good news and stock prices react positively to it. Similarly, a decrease in dividend may have a negative impact on the share prices in the stock market. Thus, the possible impact of dividend policy on the equity share price is one of the important factors considered by the management while taking a decision about it.

(i) Access to Capital Market: Large and reputed companies generally have easy access to the capital market and, therefore, may depend less on retained earning to finance their growth. These companies tend to pay higher dividends than the smaller companies which have relatively low access to the market.

(j) Legal Constraints: Certain provisions of the Companies Act place restrictions on payouts as dividend. Such provisions must be adhered to while declaring the dividend.

(k) Contractual Constraints: While granting loans to a company, sometimes the lender may impose certain restrictions on the payment of dividends in future. The companies are required to ensure that the dividend does not violate the terms of the loan agreement in this regard.

FINANCIAL PLANNING

Financial planning is essentially the preparation of a financial blueprint of an organisation's future operations. The objective of financial planning is to ensure that enough funds are available at right time. If adequate funds are not available the firm will not be able to honour its commitments and carry out its plans. On the other hand, if excess funds are available, it will unnecessarily add to the cost and

Rising Dividends can Support Valuations

Over the next few years, companies cannot afford to ignore dividends. Investors are looking for higher payouts and need the assurance of a stated dividend policy.

In India, though, there are few companies that are as consistent in dividend payments, even over the past five years.

The dividend yield, though, has steadily declined and is now at an average of 1.1 per cent for a set of 800 companies. These companies form part of the various BSE and NSE indices. Not only has the dividend yield gone down, there is not one company in this list that has increased dividends in line with profit growth in each of the past five years.

Among companies in the set, those that have steadily increased the payout over the years include a number of multinational companies that also earn a high return on net worth. Companies such as Astrazeneca Pharma, Nestle India, Hindustan Lever, Clariant, Pfizer, GlaxoSmithKline Consumer and Cummins India have enhanced dividends to deliver value to shareholders. These companies do not seem to be constrained for growth, either. Some Indian companies that have also shown the way forward include Automotive Axles, Ranbaxy Labs, Hero Honda Motors, Asian Paints, Thermax and a number of banking and non-banking finance companies. These companies, too, are growing fast, and the declaration of dividends has not dampened prospects.

Companies that have held on to profits and not declared dividends include e-Serve, Cranes Software, Sesa Goa, Tata Motors, Moser Baer, ABB, MICO, Aztec Software, Havells India, Amtek India and Sterlite Industries. This is only an indicative list and includes many more. The dividend payout ratio in the case of the indicated companies is less than 20 per cent. Investors, however, need dividends to rise and they also need a stated dividend policy. The earnings yield (inverse of PE ratio) is now at about 6 per cent. If the payout ratio were stepped up to 40 per cent then the dividend yield would rise to about 2.5 per cent.

http://www.thehindubusinessline.com/iw/2005/07/24

may encourage wasteful expenditure. It must be kept in mind that financial planning is not equivalent to, or a substitute for, financial management. Financial management aims at choosing the best investment and financing alternatives by focusing on their costs and benefits. Its objective is to increase the shareholders' wealth. Financial planning on the other hand aims at smooth operations by focusing on fund requirements and their availability in the light of financial decisions. For example, if a capital budgeting decisions is taken, the operations are likely to be at a higher scale. The amount of expenses and revenues are likely to increase. Financial planning process tries to forecast all the items which are likely to undergo changes. It enables the management to foresee the fund requirements both the quantum as well as the timing. Likely shortage and surpluses are forecast so that necessary activities are taken in advance to meet those situations. Thus, financial planning strives to achieve the following twin objectives.

(a) *To ensure availability of funds whenever required:* This include a proper estimation of the funds required for different purposes such as for the purchase of long-term assets or to meet day-to-day expenses of business etc. Apart from this, there is a need to estimate the time at which these funds are to be made available. Financial planning also tries to specify possible sources of these funds.

(b) *To see that the firm does not raise resources unnecessarily:* Excess funding is almost as bad as inadequate funding. Even if there is some surplus money, good financial planning would put it to the best possible use so that the financial resources are not left idle and don't unnecessarily add to the cost.

Thus, a proper matching of funds requirements and their availability is sought to be achieved by financial planning. This process of estimating the fund requirement of a business and specifying the sources of funds is called financial planning. Financial planning takes into consideration the growth, performance, investments and requirement of funds for a given period. Financial planning includes both short-term as well as long-term planning. Long-term planning relates to long term growth and investment. It focuses on capital expenditure programmes. Short-term planning covers short-term financial plan called budget.

Typically, financial planning is done for three to five years. For longer periods it becomes more difficult and less useful. Plans made for periods of one year or less are termed as budgets. Budgets are example of financial planning exercise in greater details. They include detailed plan of action for a period of one year or less.

Financial planning usually begins with the preparation of a sales forecast. Let us suppose a company is making a financial plan for the next five years. It will start with an estimate of the sales which are likely to happen in the next five years. Based on these, the financial statements are prepared keeping in mind the requirement of funds for investment in the fixed capital and working capital. Then the expected profits during the period are estimated so that an idea can be made of how much of the fund requirements can be met internally i.e., through retained earnings (after dividend payouts). This results in an estimation of the requirement for external funds. Further, the sources from which the external funds requirement can be met are identified and cash budgets are made, incorporating these factors.

IMPORTANCE

Financial planning is an important part of overall planning of any business enterprise. It aims at enabling the company to tackle the uncertainty in respect of the availability and timing of the funds and helps in smooth functioning of an organisation. The importance of financial planning can be explained as follows:

(i) It helps in forecasting what may happen in future under different business situations. By doing so, it helps the firms to face the eventual situation in a better way. In other words, it makes the firm better prepared to face the future. For example, a growth of 20% in sales is predicted. However, it may happen that the growth rate eventually turns out to be 10% or 30%. Many items of expenses shall be different in these three situations. By preparing a blueprint of these three situations

Cutting Back on Debt

Even successful businesses have debt, but how much is too much? Learning how to manage debt is what can put you ahead.

Taking on the right amount of debt can mean the difference between a business struggling to survive and one that can respond nimbly to changing economic or market conditions. A number of circumstances may justify acquiring debt. As a general rule, borrowing makes the most sense when you need to bolster cash flow or finance growth or expansion. But while debt can provide the leverage you need to grow, too much debt can strangle your business. So the question is: How much debt is too much?

The answer, experts say, lies in a careful analysis of your cash flow as well as your industry. A business that doesn't grow dies. You've got to grow, but you've got to grow within the financial constraints of your business. **What is the ideal capital structure a business needs in its industry to remain viable?** The higher the volatility (in your industry), the less debt you should have. The smaller the volatility, the more debt you can afford.

Although banks and other financial institutions look for a satisfactory debt-to-equity ratio before agreeing to make a loan, don't assume a creditor's willingness to extend funds is evidence that your business is in a strong debt position. Some financial institutions are overzealous lenders, particularly when trying to lure or hold on to promising business customers. "The bank may be looking more at collateral than whether the (business's) earnings are going to come in to justify the debt service.

To avoid these and other credit pitfalls, it's up to you to get the financial facts on your business and make sound borrowing decisions. Unfortunately, many entrepreneurs fail to recognise how important financial analysis is to running a successful business. Even business owners who receive detailed financial statements from their accountants often do not take advantage of the valuable information contained in the documents.

http://www.entrepreneur.com/magazine/entrepreneur/2006/December

the management may decide what must be done in each of these situations. This preparation of alternative financial plans to meet different situations is clearly of immense help in running the business smoothly.

(ii) It helps in avoiding business shocks and surprises and helps the company in preparing for the future.

(iii) If helps in co-ordinating various business functions, e.g., sales and production functions, by providing clear policies and procedures.

(iv) Detailed plans of action prepared under financial planning reduce waste, duplication of efforts, and gaps in planning.

(v) It tries to link the present with the future.

(vi) It provides a link between investment and financing decisions on a continuous basis.

(vii) By spelling out detailed objectives for various business segments, it makes the evaluation of actual performance easier.

Capital Structure

One of the important decisions under financial management relates to the financing pattern or the proportion of the use of different sources in raising funds. On the basis of ownership, the sources of business finance can be broadly classified into two categories viz., 'owners' funds' and 'borrowed funds'. Owners' funds consist of equity share capital, preference share capital and reserves and surpluses or retained earnings. Borrowed funds can be in the form of loans, debentures, public deposits etc. These may be borrowed from banks, other financial institutions, debentureholders and public.

Capital structure refers to the mix between owners and borrowed funds. These shall be referred as equity and debt in the subsequent text. It can be calculated as debt-equity ratio i.e., $\left(\frac{\text{Debt}}{\text{Equity}}\right)$ or as the proportion of debt out of the total capital i.e., $\left(\frac{\text{Debt}}{\text{Debt} + \text{Equity}}\right)$.

Debt and equity differ significantly in their cost and riskiness for the firm. The cost of debt is lower than the cost of equity for a firm because the lender's risk is lower than the equity shareholder's risk, since the lender earns an assured return and repayment of capital and, therefore, they should require a lower rate of return. Additionally, interest paid on debt is a deductible expense for computation of tax liability whereas dividends are paid out of after-tax profit. Increased use of debt, therefore, is likely to lower the over-all cost of capital of the firm provided that the cost of equity remains unaffected. Impact of a change in the debt-equity ratio upon the earning per share is dealt with in detail later in this chapter.

Debt is cheaper but is more risky for a business because the payment of interest and the return of principal is obligatory for the business. Any default in meeting these commitments may force the business to go into liquidation. There is no such compulsion in case of equity, which is therefore, considered riskless for the business. Higher use of debt increases the fixed financial charges of a business. As a result, increased use of debt increases the financial risk of a company.

Financial risk is the chance that a firm would fail to meet its payment obligations.

Capital structure of a company, thus, affects both the profitability and the financial risk. A capital structure will be said to be optimal when the proportion of debt and equity is such that it results in an increase in the value of the equity share. In other words, all decisions relating to capital structure should emphasise on increasing the shareholders' wealth.

The proportion of debt in the overall capital is also called financial

Example I

Company X Ltd.

Total Funds used	Rs. 30 Lakh
Interest rate	10% p.a.
Tax rate	30%
EBIT	Rs. 4 Lakh
Debt	
Situation I	Nil
Situation II	Rs. 10 Lakh
Situation III	Rs. 20 Lakh

EBIT-EPS Analysis

	Situation I	Situation II	Situation III
EBIT	4,00,000	4,00,000	4,00,000
Interest	NIL	1,00,000	2,00,000
EBT	4,00,000	3,00,000	2,00,000
(Earnings before taxes)			
Tax	1,20,000	90,000	60,000
EAT	2,80,000	2,10,000	1,40,000
(Earnings after taxes)			
No. of shares of Rs.10	3,00,000	2,00,000	1,00,000
EPS	0.93	1.05	1.40
(Earnings per share)			

leverage. Financial leverage is computed as $\frac{D}{E}$ or $\frac{D}{D+E}$ when D is the Debt and E is the Equity. As the financial leverage increases, the cost of funds declines because of increased use of cheaper debt but the financial risk increases. The impact of financial leverage on the profitability of a business can be seen through EBIT-EPS (Earning before Interest and Taxes-Earning per Share) analysis as in the following example.

Three situations are considered. There is no debt in situation-I i.e. (unlevered business). Debt of Rs. 10 lakh and 20 lakh are assumed in situations-II and III, respectively. All debt is at 10% p.a.

The company earns Rs. 0.93 per share if it is unlevered. With debt of Rs. 10 lakh its EPS is Rs. 1.05. With a still higher debt of Rs. 20 lakh, its, EPS rises to Rs. 1.40. Why is the EPS rising with higher debt? It is because the cost of debt is lower than the return that company is earning on funds employed. The company is earning a return on investment (RoI) of 13.33% $\left(\frac{\text{EBIT}}{\text{Total Investment}} \quad 100\right)$, $\left(\frac{4\text{Lakh}}{30\text{Lakh}} \quad 100\right)$. This is higher than the 10% interest it is paying on debt funds. With higher use of debt, this difference between RoI and cost of debt increases the EPS. This is a situation of favourable financial leverage. In such cases, companies often employ more of cheaper debt to enhance the EPS. Such practice is called Trading on Equity.

Trading on Equity refers to the increase in profit earned by the equity shareholders due to the presence of fixed financial charges like interest.

Now consider the following case of Company Y. All details are the same except that the company is earning a profit before interest and taxes of Rs. 2 lakh.

Example II

Company Y Ltd.

	Situation I	Situation II	Situation III
EBIT	2,00,000	2,00,000	2,00,000
Interest	NIL	1,00,000	2,00,000
EBT	2,00,000	1,00,000	NIL
Tax	60,000	30,000	NIL
EAT	1,40,000	70,000	NIL
No. of shares of Rs.10	3,00,000	2,00,000	1,00,000
EPS	0.47	0.35	NIL

In this example, the EPS of the company is falling with increased use of debt. It is because the Company's rate of return on investment (RoI) is less than the cost of debt. The RoI for company Y is $\frac{2\text{Lakh}}{30\text{Lakh}}$ 100, i.e., 6.67%, whereas the interest rate on debt is 10%. In such cases, the use of debt reduces the EPS. This is a situation of unfavourable financial leverage. Trading on Equity is clearly unadvisable in such a situation.

Even in case of Company X, reckless use of Trading on Equity is not recommended. An increase in debt may enhance the EPS but as pointed out earlier, it also raises the financial risk. Ideally, a company must choose that risk-return combination which maximises shareholders' wealth. The debt-equity mix that achieves it, is the optimum capital structure.

Factors affecting the Choice of Capital Structure

Deciding about the capital structure of a firm involves determining the relative proportion of various types of funds. This depends on various factors. For example, debt requires regular servicing. Interest payment and repayment of principal are obligatory on a business. In addition a company planning to raise debt must have sufficient cash to meet the increased outflows because of higher debt. Similarly, important factors which determine the choice of capital structure are as follows:

1. Cash Flow Position: Size of projected cash flows must be considered before borrowing. Cash flows must not only cover fixed cash payment obligations but there must be sufficient buffer also. It must be kept in mind that a company has cash payment obligations for (i) normal business operations; (ii) for investment in fixed assets; and (iii) for meeting the debt service commitments i.e., payment of interest and repayment of principal.

2. Interest Coverage Ratio (ICR): The interest coverage ratio refers to the number of times earnings before interest and taxes of a company covers the interest obligation. This may be calculated as follows:

$$\text{ICR} = \frac{\text{EBIT}}{\text{Interest}}$$

The higher the ratio, lower shall be the risk of company failing to meet its interest payment obligations. However, this ratio is not an adequate measure. A firm may have a high EBIT but low cash balance. Apart from interest, repayment obligations are also relevant.

3. Debt Service Coverage Ratio (DSCR): Debt Service Coverage Ratio takes care of the deficiencies referred to in the Interest Coverage Ratio (ICR). The cash profits generated by the operations are compared with the total cash required for the service of the debt and the preference share capital. It is calculated as follows:

$$\frac{\text{Profit after tax} + \text{Depreciation} + \text{Interest} + \text{Non Cash exp.}}{\text{Pref. Div} + \text{Interest} + \text{Repayment obligation}}$$

A higher DSCR indicates better ability to meet cash commitments and consequently, the company's potential to increase debt component in its capital structure.

Who funds Indian industry, why it matters?

Using data on listed Indian firms from the mid-1980s to the 1990s, several issues relating to Indian industry were investigated. One aspect then was the extremely limited extent to which promoters and entrepreneurs actually owned shares in the various companies they had control of

Proportions of the total capital of the firm	
	Percentage Share
Where did the borrowing come from?	
Borrowing from Commercial Bank	26.69
Borrowings from Financial Institutions	19.89
Debentures	7.78
Fixed deposits	3.86
Other borrowings	8.78
Who owned the shares?	
Shares held by the public at large	10.88
Foreign shareholding	3.54
Government shareholding	5.49
Institutional shareholding	8.44
Directors' shareholding	2.81
Top 50 shareholders shareholding	1.85
Total Debt and Equity Capital of a Company	**100**

Nevertheless, in spite of the relative lack of ownership, the majority of listed entities, mostly private sector companies, were managed by these founders, their successive family members and other promoters as if they were fiefdoms.

By and large, Indian companies were essentially financed by debt. This was unlike in the West. If the total debt plus nominal equity capital in the average. Indian company was 100, then 67 per cent of that amount came in the form of debt capital while equity capital contributed only 33 per cent.

If the share of government ownership in corporate equity and the share of financial institutions' equity was added, then over 60 per cent (26.69 + 19.89 + 5.49 + 8.44) of firms' finances were funded by the state in one form or another.

Foreign shareholders, in spite of a lot a clamour about their role in India's corporate economy, hardly owned more than 4 per cent (3.54) of the shares in India's listed companies. While the public at large provided about 11 per cent of the finances of an average Indian listed company, the share of the Top 50 shareholders was less than 2 (1.85) per cent.

It is within this particular shareholding category that promoters, entrepreneurs and the other large shareholders' equity stakes fall under for the purposes of classification.

The public at large provides five times as much money for the company as the entrepreneurs. Yet, a group of individuals, whose financial contributions towards a company are exceedingly small in magnitude, effectively control the company.

http://www.thehindubusinessline.com/2005/10/07

4. Return on Investment (RoI): If the RoI of the company is higher, it can choose to use trading on equity to increase its EPS, i.e., its ability to use debt is greater. We have already observed in Example I that a firm can use more debt to increase its EPS. However, in Example II, use of higher debt is reducing the EPS. It is because the firm is earning an RoI of only 6.67% which lower than its cost of debt. In example I the RoI is 13.33%, and trading on equity is profitable. It shows that, RoI is an important determinant of the company's ability to use Trading on equity and thus the capital structure.

5. Cost of debt: A firm's ability to borrow at a lower rate increases its capacity to employ higher debt. Thus, more debt can be used if debt can be raised at a lower rate.

6. Tax Rate: Since interest is a deductible expense, cost of debt is affected by the tax rate. The firms in our examples are borrowing @ 10%. Since the tax rate is 30%, the after tax cost of debt is only 7%. A higher tax rate, thus, makes debt relatively cheaper and increases its attraction vis-à-vis equity.

7. Cost of Equity: Stock owners expect a rate of return from the equity which is commensurate with the risk they are assuming. When a company increases debt, the financial risk faced by the equity holders, increases. Consequently, their desired rate of return may increase. It is for this reason that a company can not use debt beyond a point. If debt is used beyond that point, cost of equity may go up sharply and share price may decrease inspite of increased EPS. Consequently, for maximisation of shareholders' wealth, debt can be used only upto a level.

8. Floatation Costs: Process of raising resources also involves some cost. Public issue of shares and debentures requires considerable expenditure. Getting a loan from a financial institution may not cost so much. These considerations may also affect the choice between debt and equity and hence the capital structure.

9. Risk Consideration: As discussed earlier, use of debt increases the financial risk of a business. Financial risk refers to a position when a company is unable to meet its fixed financial charges namely interest payment, preference dividend and repayment obligations. Apart from the financial risk, every business has some operating risk (also called business risk). Business risk depends upon fixed operating costs. Higher fixed operating costs result in higher business risk and vice-versa. The total risk depends upon both the business risk and the financial risk. If a firm's business risk is lower, its capacity to use debt is higher and vice-versa.

10. Flexibility: If a firm uses its debt potential to the full, it loses flexibility to issue further debt. To maintain flexibility, it must maintain some borrowing power to take care of unforeseen circumstances.

11. Control: Debt normally does not cause a dilution of control. A public issue of equity may reduce the managements' holding in the company and make it vulnerable to takeover. This factor also influences the choice between debt and equity especially in companies in which the current holding of management is on a lower side.

12. Regulatory Framework: Every company operates within a regulatory framework provided by the law e.g., public issue of shares and debentures have to be made under SEBI guidelines. Raising funds from banks and other financial institutions require fulfillment of other norms. The relative ease with which these norms can, be met or the procedures completed may also have a bearing upon the choice of the source of finance.

13. Stock Market Conditions: If the stock markets are bullish, equity shares are more easily sold even at a higher price. Use of equity is often preferred by companies in such a situation. However, during a bearish phase, a company, may find raising of equity capital more difficult and it may opt for debt. Thus, stock market conditions often affect the choice between the two.

14. Capital Structure of other Companies: A useful guideline in the capital structure planning is the debt-equity ratios of other companies in the same industry. There are usually some industry norms which may help. Care however must be taken that the company does not follow the industry norms blindly. For example, if the business risk of a firm is higher, it can not afford the same financial risk. It should go in for low debt. Thus, the management must know what the industry norms are, whether they are following them or deviating from them and adequate justification must be there in both cases.

Fixed and Working Capital

Meaning

Every company needs funds to finance its assets and activities. Investment is required to be made in fixed assets and current assets. Fixed assets are those which remains in the business for more than one year, usually for much longer, e.g., plant and machinery, furniture and fixture, land and building, vehicles, etc.

Decision to invest in fixed assets must be taken very carefully as the investment is usually quite large. Such decisions once taken are irrevocable except at a huge loss. Such decisions are called capital budgeting decisions.

Current assets are those assets which, in the normal routine of the business, get converted into cash or cash equivalents within one year, e.g., inventories, debtors, bills receivables, etc.

Management of Fixed Capital

Fixed capital refers to investment in long-term assets. Management of fixed capital involves allocation of firm's capital to different projects or assets with long-term implications for the business. These decisions are called investment decisions or capital budgeting decisions and affect the growth, profitability and risk of the business in the long run. These long-term assets last for more than one year.

It must be financed through long-term sources of capital such as equity or preference shares, debentures, long-term loans and retained earnings of the business. Fixed Assets should never be financed through short-term sources.

Investment in these assets would also include expenditure on acquisition, expansion, modernisation and their replacement. These decisions include purchase of land, building, plant and machinery, launching a new product line or investing in advanced techniques of production. Major expenditures such as those on advertising campaign or research and development programme having long term implications for the firm are also examples of capital budgeting decisions. The management of fixed capital or investment or capital budgeting decisions are important for the following reasons:

(i) *Long-term growth:* These decisions have bearing on the long-term growth. The funds invested in long-term assets are likely to yield returns in the future. These will affect the future prospects of the business.

(ii) *Large amount of funds involved:* These decisions result in a substantial portion of capital funds being blocked in long-term projects. Therefore, these investments are planned after a detailed analysis is undertaken. This may involve decisions like where to procure funds from and at what rate of interest.

(iii) *Risk involved:* Fixed capital involves investment of huge amounts. It affects the returns of the firm as a whole in the long-term. Therefore, investment decisions involving fixed capital influence the overall business risk complexion of the firm.

(iv) *Irreversible decisions:* These decisions once taken, are not reversible without incurring heavy losses. Abandoning a project after heavy investment is made is quite costly in terms of waste of funds. Therefore, these decisions should be taken only after carefully evaluating each detail or else the adverse financial consequences may be very heavy.

Factors affecting the Requirement of Fixed Capital

1. Nature of Business: The type of business has a bearing upon the fixed capital requirements. For example, a trading concern needs lower investment in fixed assets compared with a manufacturing organisation; since it does not require to purchase plant and machinery, etc.

2. Scale of Operations: A larger organisation operating at a higher scale needs bigger plant, more space etc. and therefore, requires higher investment in fixed assets when compared with the small organisation.

3. Choice of Technique: Some organisations are capital intensive whereas others are labour intensive. A capital-intensive organisation requires higher investment in plant and machinery as it relies less on manual labour. The requirement of fixed capital for such organisations would be higher. Labour intensive organisations on the other hand require less investment in fixed assets. Hence, their fixed capital requirement is lower.

4. Technology Upgradation: In certain industries, assets become obsolete sooner. Consequently, their replacements become due faster. Higher investment in fixed assets may, therefore, be required in such cases. For example, computers become obsolete faster and are replaced much sooner than say, furniture. Thus, such organisations which use assets which are prone to obsolescence require higher fixed capital to purchase such assets.

5. Growth Prospects: Higher growth of an organisation generally requires higher investment in fixed assets. Even when such growth is expected, a company may choose to create higher capacity in order to meet the anticipated higher demand quicker. This entails larger investment in fixed assets and consequently larger fixed capital.

6. Diversification: A firm may choose to diversify its operations for various reasons, With diversification, fixed capital requirements increase e.g., a textile company is diversifying and starting a cement manufacturing plant. Obviously, its investment in fixed capital will increase.

7. Financing Alternatives: A developed financial market may provide leasing facilities as an alternative to outright purchase. When an asset is taken on lease, the firm pays lease rentals and uses it. By doing so, it avoids huge sums required to purchase it. Availability of leasing facilities, thus, may reduce the funds required to be invested in fixed assets, thereby reducing the fixed capital requirements. Such a strategy is specially suitable in high risk lines of business.

8. Level of Collaboration: At times, certain business organisations share each other's facilities. For example, a bank may use another's ATM or some of them may jointly establish a particular facility. This is feasible if the scale of operations of each one of them is not sufficient to make full use of the facility. Such collaboration reduces the level of investment in fixed assets for each one of the participating organisations.

Working Capital

Apart from the investment in fixed assets every business organisation needs to invest in current assets. This investment facilitates smooth day-to-day operations of the business. Current assets are usually more liquid but contribute less to the profits than fixed assets. Examples of current assets, in order of their liquidity, are as under.

1. Cash in hand/Cash at Bank
2. Marketable securities
3. Bills receivable
4. Debtors
5. Finished goods inventory
6. Work in progress
7. Raw materials
8. Prepaid expenses

These assets, as noted earlier, are expected to get converted into cash or cash equivalents within a period of one year. These provide liquidity to the business. An asset is more liquid if it can be converted into cash quicker and without reduction in value. Insufficient investment in current assets may make it more difficult for an organisation to meet its payment obligations. However, these assets provide little or low return. Hence, a balance needs to be struck between liquidity and profitability.

Current liabilities are those payment obligations which are due for payment within one year; such as bills payable, creditors, outstanding expenses and advances received from customers, etc.

Some part of current assets is usually financed through short-term sources, i.e., current liabilities. The rest is financed through long-term sources and is called net working capital. Thus, NWC = CA – CL (i.e. Current Assets – Current Liabilities.)

Working Capital Position

"Its been a rather glamorous 18 months, with sales just huge," says, CFO of PT Astra International, the US $4 billion in sales Indonesian automaker. Indonesia is on the growth path again, and a new breed of consumer is eager for a first vehicle – motorcycles – as well as Astra's more premium brands of Hondas and Toyotas. And one of the most beautiful parts of the proposition is that working capital management seems to be taking care of itself. "Depending on the business, and counting trade receivables only, we have between eight and 19 days working capital," which is manageable given the company's steady growth. One of the reasons that working capital has not expanded at the rate of the business is inventory, or rather the dearth of it. "We're in a market that responds very strongly to new products," says the manager "and the presales of products are very high. We have advanced orders from four to six months, with deposits paid, and this helps our cash position." Best of all, as soon as a vehicle is off the assembly line, it's out to the dealer. "We have low inventory costs and the product lines are very easy to move." The salutary role of banks in working capital management is one reason that cashflow has improved in his business. Better management is a result of banking competition that has allowed the company to move from traditional bankers, the state-owned Indian institutions, to more competitive private institutions and the foreign banks that partner with them. These banks have invested in technology, allowing a visibility over cashflow unheard of five years ago.

http://www.cfoasia.com/archives/200503-02.htm

Thus, net working capital may be defined as the excess of current assets over current liabilities.

Factors Affecting the Working Capital Requirements

1. Nature of Business: The basic nature of a business influences the amount of working capital required. A trading organisation usually needs a smaller amount of working capital compared to a manufacturing organisation. This is because there is usually no processing. Therefore, there is no distinction between raw materials and finished goods. Sales can be effected immediately upon the receipt of materials, sometimes even before that. In a manufacturing business, however, raw material needs to be converted into finished goods before any sales become possible. Other factors remaining the same, a trading business requires less working capital. Similarly, service industries which usually do not have to maintain inventory require less working capital.

2. Scale of Operations: For organisations which operate on a higher scale of operation, the quantum of inventory and debtors required is generally high. Such organisations, therefore, require large amount of working capital as compared to the organisations which operate on a lower scale.

3. Business Cycle: Different phases of business cycles affect the requirement of working capital by a firm. In case of a boom, the sales as well as production are likely to be larger and, therefore, larger amount of working capital is required. As against this, the requirement for working capital will be lower during the period of depression as the sales as well as production will be small.

4. Seasonal Factors: Most business have some seasonality in their operations. In peak season, because of higher level of activity, larger amount of working capital is required. As against this, the level of activity as well as the requirement for working capital will be lower during the lean season.

5. Production Cycle: Production cycle is the time span between the receipt of raw material and their conversion into finished goods. Some businesses have a longer production cycle while some have a shorter one. Duration and the length of production cycle, affects the amount of funds required for raw materials and expenses. Consequently, working capital requirement is higher in firms with longer processing cycle and lower in firms with shorter processing cycle.

6. Credit Allowed: Different firms allow different credit terms to their customers. These depend upon the level of competition that a firm faces as well as the credit worthiness of their clientele. A liberal credit policy results in higher amount of debtors, increasing the requirement of working capital.

7. Credit Availed: Just as a firm allows credit to its customers it also may get credit from its suppliers. To the extent it avails the credit on purchases, the working capital requirement is reduced.

8. Operating Efficiency: Firms manage their operations with varied degrees of efficiency. For example, a firm managing its raw materials efficiently may be able to manage with a smaller balance. This is reflected in a higher inventory turnover ratio. Similarly, a better debtors turnover ratio may be achieved reducing the amount tied up in receivables. Better sales effort may reduce the average time for which finished goods inventory is held. Such efficiencies may reduce the level of raw materials, finished goods and debtors resulting in lower requirement of working capital.

9. Availability of Raw Material: If the raw materials and other required materials are available freely and continuously, lower stock levels may suffice. If, however, raw materials do not have a record of un-interrupted availability, higher stock levels may be required. In addition, the time lag between the placement of order and the actual receipt of the materials (also called lead time) is also relevant. Larger the lead time, larger the quantity of material to be stored and larger shall be the amount of working capital required.

10. Growth Prospects: If the growth potential of a concern is perceived to be higher, it will require larger amount of working capital so that it is able to meet higher production and sales target whenever required.

11. Level of Competition: Higher level of competitiveness may necessitate larger stocks of finished goods to meet urgent orders from customers. This increases the working capital requirement. Competition may also force the firm to extend liberal credit terms discussed earlier.

12. Inflation: With rising prices, larger amounts are required even to maintain a constant volume of production and sales. The working capital requirement of a business thus, become higher with higher rate of inflation. It must, however, be noted that an inflation rate of 5%, does not mean that every component of working capital will change by the same percentage. The actual requirement shall depend upon the rates of price change of different components (e.g., raw material, finished goods, labour cost,) Finished goods as well as their proportion in the total requirement.

KEY TERMS

Financial Management	Wealth Maximisation	Investment Decision
Financing Decision	Dividend Decision	Capital Budgeting
Working Capital	Financial Planning	Capital Structure
Trading on Equity		

SUMMARY

Business finance: The money required for carrying out business activities is called business finance. Almost all business activities require some finance. Finance is needed to establish a business, to run it, to modernise it, to expand, and diversify it.

Financial Management: Financial Management is concerned with optimal procurement as well as usage of finance. For optimal procurement, different available sources of finance are identified and compared in terms of their costs and associated risks.

Objectives and Financial Decisions The primary aim of financial management is to maximise shareholders' wealth which is referred to as the wealth maximisation concept. The market price of a company's shares are linked to the three basic financial decisions

Financial decision-making is concerned with three broad decisions which are Investment Decision, Financing Decision, Dividend Decision

Financial Planning and Importance Financial planning is essentially preparation of a financial blueprint of an organisation's future operations. The objective of financial planning is to ensure that enough funds are available at right time.

Financial planning strives to achieve the following twin objectives.

(a) To ensure availability of funds whenever these are required:
(b) To see that the firm does not raise resources unnecessarily:

Financial planning is an important part of overall planning of any business enterprise. It aims at enabling the company to tackle the uncertainty in respect of the availability and timing of the funds and helps in smooth functioning of an organisation.

Capital Structure and Factors One of the important decisions under financial management relates to the financing pattern or the proportion of the use of different sources in raising funds. On the basis of ownership, the sources of business finance can be broadly classified into two categories viz., 'owners funds' and 'borrowed funds'. Capital structure refers to the mix between owners and borrowed funds.

Deciding about the capital structure of a firm involves determining the relative proportion of various types of funds. This depends on various factors which are: Cash Flow Position, Interest Coverage Ratio (ICR), Debt Service Coverage Ratio (DSCR), Return on Investment (RoI), Cost of debt, Tax Rate, Cost of Equity, Floatation Costs, Risk Consideration, Flexibility, Control, Regulatory Framework, Stock Market Conditions, and Capital Structure of other Companies.

Fixed and Working Capital Fixed capital refers to investment in long-term assets. Management of fixed capital involves around allocation of firm's capital to different projects or assets with long-term implications for the business. These decisions are called investment decisions or capital budgeting decisions. They affect the growth, profitability and risk of the business in the long run.

Factors affecting the Requirement of Fixed Capital are: Nature of Business, Scale of Operations, Choice of Technique, Technology Upgradation, Growth Prospects, Diversification, Financing Alternatives and Level of Collaboration.

Apart from the investment in fixed assets, every business organisation needs to invest in current assets. This investment facilitates smooth day-to-day operations of the organisation. Current assets are usually more liquid but contribute less to the profits than fixed assets.

Factors affecting the working capital requirement are: Nature of Business, Scale of Operations, Business Cycle, Seasonal Factor, Production Cycle, Credit Allowed, Credit Availed, Operating Efficiency, Availability of Raw Material, Growth Prospects, Level of competition, and rate of Inflation.

EXERCISES

Objective–type questions

1. The cheapest source of finance is:
   a. debenture b. equity share capital
   c. preference share d. retained earning
2. A decision to acquire a new and modern plant to upgrade an old one is a:
   a. financing decision
   b. working capital decision
   c. investment decision
   d. None of the above
3. Other things remaining the same, an increase in the tax rate on corporate profits will:
   a. make the debt relatively cheaper
   b. make the debt relatively the dearer
   c. have no impact on the cost of debt
   d. we can't say

4. Companies with a higher growth pattern are likely to:
   a. pay lower dividends
   b. pay higher dividends
   c. dividends are not affected by growth considerations
   d. none of the above
5. Financial leverage is called favourable if:
   a. Return on Investment is lower than the cost of debt
   b. ROI is higher than the cost of debt
   c. Debt is easily available
   d. If the degree of existing financial leverage is low
6. Higher debt-equity ratio results in:
   a. lower financial risk
   b. higher degree of operating risk
   c. higher degree of financial risk
   d. higher EPS
7. Higher working capital usually results in:
   a. higher current ratio, higher risk and higher profits
   b. lower current ratio, higher risk and profits
   c. higher equity, lower risk and lower profits
   d. lower equity, lower risk and higher profits
8. Current assets are those assets which get converted into cash:
   a. within six months
   b. within one year
   c. between one and three years
   d. between three and five years
9. Financial planning arrives at:
   a. minimising the external borrowing by resorting to equity issues
   b. entering that the firm always have significantly more fund than required so that there is no paucity of funds
   c. ensuring that the firm faces neither a shortage nor a glut of unusable funds
   d. doing only what is possible with the funds that the firms has at its disposal

10. Higher dividend per share is associated with:
    a. high earnings, high cash flows, unstable earnings and higher growth opportunities
    b. high earnings, high cash flows, stable earnings and high growth opportunities
    c. high earnings, high cash flows, stable earnings and lower growth opportunities
    d. high earnings, low cash flows, stable earnings and lower growth opportunities
11. A fixed asset should be financed through:
    a. a long-term liability b. a short-term liability
    c. a mix of long and short-term liabilities
12. Current assets of a business firm should be financed through:
    a. current liability only b. long-term liability only
    c. both types (i.e. long and short term liabilities)

Short answer questions

1. What is meant by capital structure?
2. Discuss the two objectives of financial planning.
3. What is 'Financial Risk?' Why does it arise?
4. Define 'Current Assets'. Give four examples of such assets.
5. Financial management is based on three broad financial decisions. What are these?
6. What are the main objectives of financial management? Briefly explain.
7. How does working capital affect both the liquidity as well as profitability of a business?

Long answer questions

1. What is working capital? How is it calculated? Discuss five important determinants of working capital requirement.
2. "Capital structure decision is essentially optimisation of risk-return relationship." Comment.
3. "A capital budgeting decision is capable of changing the financial fortunes of a business." Do you agree? Give reasons for your answer?
4. Explain the factors affecting the dividend decision.

5. Explain the term 'Trading on Equity'. Why, when and how it can be used by a company?

Case Problem

'S' Limited is manufacturing steel at its plant in India. It is enjoying a buoyant demand for its products as economic growth is about 7%-8% and the demand for steel is growing. It is planning to set up a new steel plant to cash on the increased demand. It is estimated that it will require about Rs. 5000 crores to set up and about Rs 500 crores of working capital to start the new plant.

Questions

1. Describe the role and objectives of financial management for this company.
2. Explain the importance of having a financial plan for this company. Give an imaginary plan to support your answer.
3. What are the factors which will affect the capital structure of this company?
4. Keeping in mind that it is a highly capital-intensive sector, what factors will affect the fixed and working capital. Give reasons in support of your answer.

Project Work

1. Pick up the annual reports of 2 or more companies engaged in the same line of business. You can access this data on the respective website of the companies and other sources. Compare their capital structures. Analyse the reasons for the difference. You can also use ratio analysis for this. Prepare a report of your findings and discuss it in the class with the help of your teacher.
2. From the annual reports that you use in activity, analyse the working capital of the companies. You can use short-term solvency ratios. Study the operating cycle of the line of business you have choosen and prepare a report as to the soundness of the working capital management of the companies you are studying. Prepare a report of your findings and discuss it in class with the help of your teacher.

CHAPTER 10

FINANCIAL MARKETS

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- explain the meaning of Financial Market;
- explain the meaning of Money Market and describe its major Instruments;
- explain the nature and types of Capital Market;
- distinguish between Money Market and Capital Market;
- explain the meaning and functions of Stock Exchange;
- describe the functioning of NSEI and OTCEI; and
- describe the role of SEBI in investor protection.

IDEA SEEKS TO CAPITALISE ON MARKET MOMENTUM

With the explosive growth of their subscriber base, telecom companies are all looking at capital markets to raise funds to fuel their expansion plan. Idea Cellular, the fifth largest operator in the country and the flagship telecom venture of AV Birla Group, has decided to enter the capital market to raise between Rs. 1,700 and Rs. 2,000 crore.

The company has appointed J.M. Morgan Stanley, Merrill Lynch among other as book-runners for the proposed Initial Public Offer (IPO), which is expected to be ready by January end.

Since, under SEBI norms, the minimum float size is 10 per cent, the company will divest between 10 and 12 per cent, "The last private placement made by the promoters is at a market capitalisation of Rs. 15,000 crore. The proposed float is expected to be at 10 to 20 per cent premium of the private placement price," AV Birla Group recently divested 35 per cent stake in the company to a clutch of private equity firms. However, this is a fresh issue of shares, where the proceeds will be utilised by Ideal Cellular for capital expenditure. After the proposed issues, the promoters stake will come down to around 58 per cent.

Source: www.hindustantimes.com

Introduction

You all know that a business needs finance from the time an entrepreneur makes the decision to start it. It needs finance both for working capital requirements such as payments for raw materials and salaries to its employees, and fixed capital expenditure such as the purchase of machinery or building or to expand its production capacity. The above example gives a fair picture of how companies need to raise funds from the capital markets. Idea Cellular decided to enter the Indian capital market for its needs of expansion. In this chapter you will study concepts like private placement, Initial public Offer (IPO) and capital markets which you come across in the example of Idea Cellular. Business can raise these funds from various sources and in different ways through financial markets. This chapter provides a brief description of the mechanism through which finances are mobilised by a business organisation for both short term and long term requirements. It also explains the institutional structure and the regulatory measures for different financial markets.

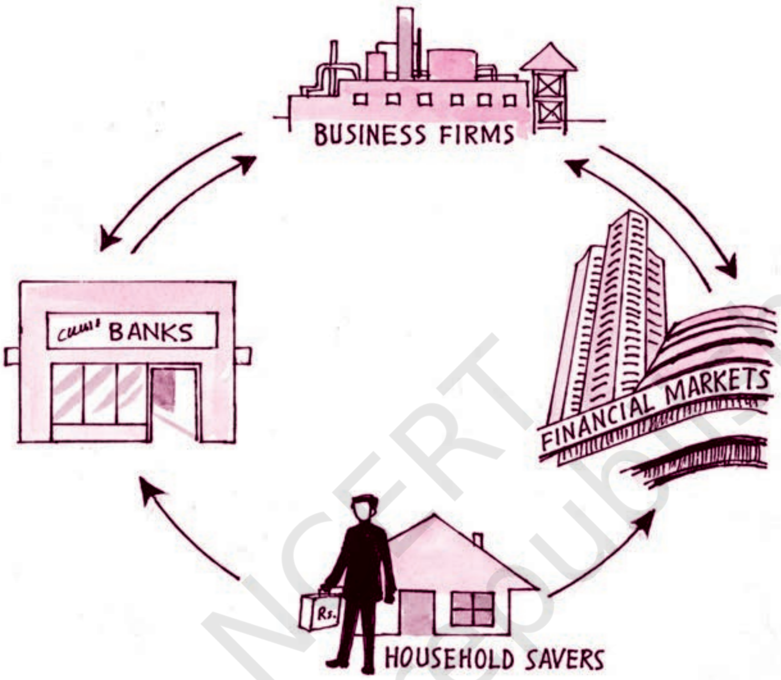
Concept of Financial Market

A business is a part of an economic system that consists of two main sectors – households which save funds and business firms which invest these funds. A financial market helps to link the savers and the investors by mobilizing funds between them. In doing so it performs what is known as an allocative function. It allocates or directs funds available for investment into their most productive investment opportunity. When the allocative function is performed well, two consequences follow:

- The rate of return offered to households would be higher
- Scarce resources are allocated to those firms which have the highest productivity for the economy.

There are two major alternative mechanisms through which allocation of funds can be done: via banks or via financial markets. Households can deposit their surplus funds with banks, who in turn could lend these funds to business firms. Alternately, households can buy the shares and debentures offered by a business using financial markets. The process by which allocation of funds is done is called financial intermediation. Banks and financial markets are competing intermediaries in the financial system, and give households a choice of where they want to place their savings.

A financial market is a market for the creation and exchange of financial assets. Financial markets exist wherever a financial transaction occurs. Financial transactions could be in the form of creation of financial assets such as the initial issue of shares and debentures by a firm or the purchase and sale of existing financial assets like equity shares, debentures and bonds.



Financial System

FUNCTIONS OF FINANCIAL MARKET

Financial markets play an important role in the allocation of scarce resources in an economy by performing the following four important functions.

1. Mobilisation of Savings and Channeling them into the most Productive Uses: A financial market facilitates the transfer of savings from savers to investors. It gives savers the choice of different investments and thus helps to channelise surplus funds into the most productive use.

2. Facilitating Price Discovery: You all know that the forces of demand and supply help to establish a price for a commodity or service in the market. In the financial market, the households are suppliers of funds and business firms represent the demand. The interaction between them helps to establish a price for the financial asset which is being traded in that particular market.

3. Providing Liquidity to Financial Assets: Financial markets facilitate easy purchase and sale of financial assets. In doing so they provide liquidity to financial assets, so that they can be easily converted into cash whenever required. Holders of assets can readily sell their financial assets through the mechanism of the financial market.

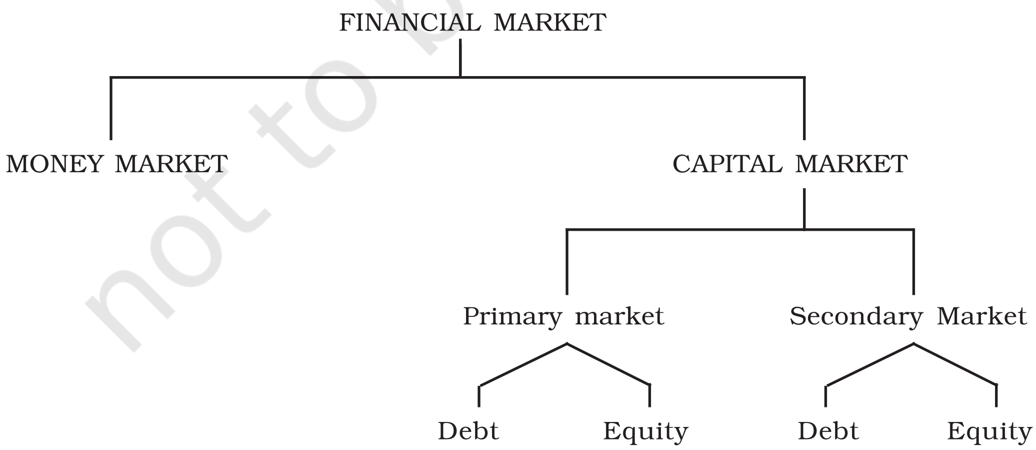
4.Reducing the Cost of Transactions: Financial markets provide valuable information about securities being traded in the market. It helps to save time, effort and money that both buyers and sellers of a financial asset would have to otherwise spend to try and find each other. The financial market is thus, a common platform where buyers and sellers can meet for fulfillment of their individual needs.

Financial markets are classified on the basis of the maturity of financial instruments traded in them. Instruments with a maturity of less than one year are traded in the money market. Instruments with longer maturity are traded in the capital market.

Money Market

The money market is a market for short term funds which deals in monetary assets whose period of maturity is upto one year. These assets are close substitutes for money. It is a market where low risk, unsecured and short term debt instruments that are highly liquid are issued and actively traded everyday. It has no physical location, but is an activity conducted over the telephone and through the internet. It enables the raising of short-term funds for meeting the temporary shortages of cash and obligations and the temporary deployment of excess funds for earning returns. The major participants in the market are the Reserve Bank of India

Classification of Financial Markets



(RBI), Commercial Banks, Non-Banking Finance Companies, State Governments, Large Corporate Houses and Mutual Funds.

Money Market Instruments

1. Treasury Bill: A Treasury bill is basically an instrument of short-term borrowing by the Government of India maturing in less than one year. They are also known as Zero Coupon Bonds issued by the Reserve Bank of India on behalf of the Central Government to meet its short-term requirement of funds. Treasury bills are issued in the form of a promissory note. They are highly liquid and have assured yield and negligible risk of default. They are issued at a price which is lower than their face value and repaid at par. The difference between the price at which the treasury bills are issued and their redemption value is the interest receivable on them and is called discount. Treasury bills are available for a minimum amount of Rs 25,000 and in multiples thereof.

Example: Suppose an investor purchases a 91 days Treasury bill with a face value of Rs. 1,00,000 for Rs. 96,000. By holding the bill until the maturity date, the investor receives Rs. 1,00,000. The difference of Rs. 4,000 between the proceeds received at maturity and the amount paid to purchase the bill represents the interest received by him.

2. Commercial Paper: Commercial paper is a short-term unsecured promissory note, negotiable and transferable by endorsement and delivery with a fixed maturity period. It is issued by large and creditworthy companies to raise short-term funds at lower rates of interest than market rates. It usually has a maturity period of 15 days to one year. The issuance of commercial paper is an alternative to bank borrowing for large companies that are generally considered to be financially strong. It is sold at a discount and redeemed at par. The original purpose of commercial paper was to provide short-terms funds for seasonal and working capital needs. For example companies use this instrument for purposes such as bridge financing.

Example: Suppose a company needs long-term finance to buy some machinery. In order to raise the long term funds in the capital market the company will have to incur floatation costs (costs associated with floating of an issue are brokerage, commission, printing of applications and advertising etc.). Funds raised through commercial paper are used to meet the floatation costs. This is known as Bridge Financing.

3. Call Money: Call money is short term finance repayable on demand, with a maturity period of one day to fifteen days, used for inter-bank transactions. Commercial banks have to maintain a minimum cash balance known as cash reserve ratio. The Reserve Bank of India changes the cash reserve ratio from time to time which in turn affects the amount of funds available to be given as loans by commercial banks. Call money is a method by which banks borrow from each other to be able to maintain the cash reserve ratio. The interest rate paid on call money loans is known as the call rate. It is a highly volatile rate that varies from day-to-day and sometimes even from hour-to-hour. There is an inverse relationship between call rates and other short-term money market instruments such as certificates of deposit and commercial paper. A rise in call money rates makes other sources of finance such as commercial paper and certificates of deposit cheaper in comparison for banks raise funds from these sources.

4. Certificate of Deposit: Certificates of deposit (CD) are unsecured, negotiable, short-term instruments in bearer form, issued by commercial banks and development financial institutions. They can be issued to individuals, corporations and companies during periods of tight liquidity when the deposit growth of banks is slow but the demand for credit is high. They help to mobilise a large amount of money for short periods.

5. Commercial Bill: A commercial bill is a bill of exchange used to finance the working capital requirements of business firms. It is a short-term, negotiable, self-liquidating instrument which is used to finance the credit sales of firms. When goods are sold on credit, the buyer becomes liable to make payment on a specific date in future. The seller could wait till the specified date or make use of a bill of exchange. The seller (drawer) of the goods draws the bill and the buyer (drawee) accepts it. On being accepted, the bill becomes a marketable instrument and is called a trade bill. These bills can be discounted with a bank if the seller needs funds before the bill matures. When a trade bill is accepted by a commercial bank it is known as a commercial bill.

Sterlite Industries

Sterlite Industries, part of the London listed Vedanta Resources Group, is scheduled to be listed on the New York Stock Exchange through an initial public offering (IPO) of about $2 billion. The proceeds will be used to fund its $1.9 billion, Greenfield power project in Orissa and to expand its aluminium and copper facilities.

The IPO is a part of an enabling resolution passed by Sterlite to raise upto 12,500 crores through American Depository Shares (ADS). Consequently, the company has increased its authorised capital from Rs 150 crore to Rs 185 crore by creating an additional 17.5 crore equity shares of Rs 2 each. The shares of Sterlite, which will be among the first metal firms from India to list on NYSE, outpaced Sensex and rose by 1.4% to close at Rs 545.2 on BSE on the day of the announcement.

Source: The Economic Times

Capital Market

The term capital market refers to facilities and institutional arrangements through which long-term funds, both debt and equity are raised and invested. It consists of a series of channels through which savings of the community are made available for industrial and commercial enterprises and for the public in general. It directs these savings into their most productive use leading to growth and development of the economy. The capital market consists of development banks, commercial banks and stock exchanges.

An ideal capital market is one where finance is available at reasonable cost. The process of economic development is facilitated by the existence of a well functioning capital market. In fact, development of the financial system is seen as a necessary condition for economic growth. It is essential that financial institutions are sufficiently developed and that market operations are free, fair, competitive and transparent. The capital market should also be efficient in respect of the information that it delivers, minimise transaction costs and allocate capital most productively.

The Capital Market can be divided into two parts: a. Primary Market b. Secondary Market

Distinction between Capital Market and Money Market

The major points of distinction between the two markets are as follows:

(i) *Participants:* The participants in the capital market are financial institutions, banks, corporate entities, foreign investors and ordinary retail investors from members of the public. Participation in the money market is by and large undertaken by institutional participants such as the RBI, banks, financial institutions and finance companies. Individual investors although permitted to transact in the secondary money market, do not normally do so.

(ii) *Instruments:* The main instruments traded in the capital market are – equity shares, debentures, bonds, preference shares etc. The main instruments traded in the money market are short term debt instruments such as T-bills, trade bills reports, commercial paper and certificates of deposit.

(iii) *Investment Outlay:* Investment in the capital market i.e. securities does not necessarily require a huge financial outlay. The value of units of securities is generally low i.e. Rs 10, Rs 100 and so is the case with minimum trading lot of shares which is kept small i.e. 5, 50, 100 or so. This helps individuals with small savings to subscribe to these securities. In the money market, transactions entail huge sums of money as the instruments are quite expensive.

(iv) *Duration:* The capital market deals in medium and long term securities such as equity shares and debentures. Money market instruments have a maximum tenure of one year, and may even be issued for a single day.

(v) *Liquidity:* Capital market securities are considered liquid investments because they are marketable on the stock exchanges. However, a share may not be actively traded, i.e. it may not easily find a buyer. Money market instruments on the other hand, enjoy a higher degree of liquidity as there is formal arrangement for this. The Discount Finance House of India (DFHI) has been established for the specific objective of providing a ready market for money market instruments.

(vi) *Safety:* Capital market instruments are riskier both with respect to returns and principal repayment. Issuing companies may fail to perform as per projections and promoters may defraud investors. But the money market is generally much safer with a minimum risk of default. This is due to the shorter duration of investing and also to financial soundness of the issuers, which primarily are the government, banks and highly rated companies.

(vii) *Expected return:* The investment in capital markets generally yield a higher return for investors than the money markets. The possibility of earnings is higher if the securities are held for a longer duration. First, there is the scope of earning capital gains in equity share. Second, in the long run, the prosperity of a company is shared by shareholders by way of high dividends and bonus issues.

PRIMARY MARKET

The primary market is also known as the new issues market. It deals with new securities being issued for the first time. The essential function of a primary market is to facilitate the transfer of investible funds from savers to entrepreneurs seeking to establish new enterprises or to expand existing ones through the issue of securities for the first time. The investors in this market are banks, financial institutions, insurance companies, mutual funds and individuals.

A company can raise capital through the primary market in the form of equity shares, preference shares, debentures, loans and deposits. Funds raised may be for setting up new projects, expansion, diversification, modernisation of existing projects, mergers and takeovers etc.

Methods of Floatation

There are various methods of floating new issues in the primary market :

1. Offer through Prospectus: Offer through prospectus is the most popular method of raising funds by public companies in the primary market. This involves inviting subscription from the public through issue of prospectus. A prospectus makes a direct appeal to investors to raise capital, through an advertisement in newspapers and magazines. The issues may be underwritten and also are required to be listed on at least one stock exchange. The contents of the prospectus have to be in accordance with the provisions of the Companies Act and SEBI disclosure and investor protection guidelines.

2. Offer for Sale: Under this method securities are not issued directly to the public but are offered for sale through intermediaries like issuing houses or stock brokers. In this case, a company sells securities enbloc at an agreed price to brokers who, in turn, resell them to the investing public.

3. Private Placement: Private placement is the allotment of securities by a company to institutional investors and some selected individuals. It helps to raise capital more quickly than a public issue. Access to the primary market can be expensive on account of various mandatory and non-mandatory expenses. Some companies, therefore, cannot afford a public issue and choose to use private placement.

4. Rights Issue: This is a privilege given to existing shareholders to subscribe to a new issue of shares according to the terms and conditions of the company. The shareholders are offered the 'right' to buy new shares in proportion to the number of shares they already possess.

5. e-IPOs: A company proposing to issue capital to the public through the on-line system of the stock exchange has to enter into an agreement with the

PRIMARY AND SECONDARY MARKETS —A COMPARISON

Primary Market (New Issue Market)	*Secondary Market (Stock Exchange)*
(i) There is sale of securities by new companies or further (new issues of securities by existing companies to investors).	(i) There is trading of existing shares only.
(ii) Securities are sold by the company to the investor directly (or through an intermediary).	(ii) Ownership of existing securities is exchanged between investors. The company is not involved at all.
(iii) The flow of funds is from savers to investors, i.e. the primary market directly promotes capital formation.	(iii) Enhances encashability (liquidity) of shares, i.e. the secondary market indirectly promotes capital formation.
(iv) Only buying of securities takes place in the primary market, securities cannot be sold there.	(iv) Both the buying and the selling of securities can take place on the stock exchange.
(v) Prices are determined and decided by the management of the company.	(v) Prices are determined by demand and supply for the security.
(vi) There is no fixed geographical location.	(vi) Located at specified places.

stock exchange. This is called an Initial Public Offer (IPO). SEBI registered brokers have to be appointed for the purpose of accepting applications and placing orders with the company. The issuer company should also appoint a registrar to the issue having electronic connectivity with the exchange. The issuer company can apply for listing of its securities on any exchange other than the exchange through which it has offered its securities. The lead manager coordinates all the activities amongst intermediaries connected with the issue.

SECONDARY MARKET

The secondary market is also known as the stock market or stock exchange. It is a market for the purchase and sale of existing securities. It helps existing investors to disinvest and fresh investors to enter the market. It also provides liquidity and marketability to existing securities. It also contributes to economic growth by channelising funds towards the most productive investments through the process of disinvestment and reinvestment. Securities are traded, cleared and settled within the regulatory framework prescribed by SEBI. Advances in information technology have made trading through stock exchanges accessible from anywhere in the country through trading terminals. Along with the growth of the primary market in the country, the secondary market has also grown significantly during the last ten years.

STOCK EXCHANGE

A stock exchange is an institution which provides a platform for buying and selling of existing securities. As a market, the stock exchange facilitates the exchange of a security (share,

History of the Stock Market in India

The history of the stock market in India goes back to the end of the eighteenth century when long-term negotiable securities were first issued. In 1850 the Companies Act was introduced for the first time bringing with it the feature of limited liability and generating investor interest in corporate securities. The first stock exchange in India was set-up in 1875 as The Native Share and Stock Brokers Association in Bombay. Today it is known as the Bombay Stock Exchange (BSE). This was followed by the development of exchanges in Ahmedabad (1894), Calcutta(1908) and Madras(1937). It is interesting to note that stock exchanges were first set up in major centers of trade and commerce.

Until the early 1990s, the Indian secondary market comprised regional stock exchanges with BSE heading the list. After the reforms of 1991, the Indian secondary market acquired a three tier form. This consists of:

- Regional Stock Exchanges
- National Stock Exchange (NSE)
- Over the Counter Exchange of India (OTCEI)

Bombay Stock Exchange

debenture etc.) into money and vice versa. Stock exchanges help companies raise finance, provide liquidity and safety of investment to the investors and enhance the credit worthiness of individual companies.

Meaning of Stock Exchange

According to Securities Contracts (Regulation) Act 1956, stock exchange means any body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying and selling or dealing in securities.

Functions of a Stock Exchange

The efficient functioning of a stock exchange creates a conducive climate for an active and growing primary market for new issues. An active and healthy secondary market in existing securities leads to positive environment among investors. The following are some of the important functions of a stock exchange.

1. Providing Liquidity and Marketability to Existing Securities: The basic function of a stock exchange is the creation of a continuous market where securities are bought and sold. It gives investors the chance to disinvest and reinvest. This provides both liquidity and easy marketability to already existing securities in the market.

2. Pricing of Securities: Share prices on a stock exchange are determined by the forces of demand and supply. A stock exchange is a mechanism of constant valuation through which the prices of securities are determined. Such a valuation provides important instant information to both buyers and sellers in the market.

3. Safety of Transaction: The membership of a stock exchange is well-regulated and its dealings are well defined according to the existing legal framework. This ensures that the investing public gets a safe and fair deal on the market.

4. Contributes to Economic Growth: A stock exchange is a market in which existing securities are resold or traded. Through this process of disinvestment and reinvestment savings get channelised into their most productive investment avenues. This leads to capital formation and economic growth.

5. Spreading of Equity Cult: The stock exchange can play a vital role in ensuring wider share ownership by regulating new issues, better trading practices and taking effective steps in educating the public about investments.

6. Providing Scope for Speculation: The stock exchange provides sufficient scope within the provisions of law for speculative activity in a restricted and controlled manner. It is generally accepted that a certain degree of healthy speculation is necessary to ensure liquidity and price continuity in the stock market.

Trading and Settlement Procedure

Trading in securities is now executed through an on-line, screen-based electronic trading system. Simply put, all buying and selling of shares and debentures are done through a computer terminal.

There was a time when in the open outcry system, securities were bought and sold on the floor of the stock exchange. Under this auction system, deals were struck among brokers, prices were shouted out and the shares sold to the highest bidder. However, now almost all exchanges have gone

Electronic Trading System

electronic and trading is done in the broker's office through a computer terminal. A stock exchange has its main computer system with many terminals spread across the country. Trading in securities is done through brokers who are members of the stock exchange. Trading has shifted from the stock market floor to the brokers office.

Every broker has to have access to a computer terminal that is connected to the main stock exchange. In this screen-based trading, a member logs on to the site and any information about the shares (company, member, etc.) he wishes to buy or sell and the price is fed into the computer. The software is so designed that the transaction will be executed when a matching order is found from a counter party. The whole transaction is carried on the computer screen with both the parties being able to see the prices of all shares going up and down at all times during the time that business is transacted and during business hours of the stock exchange. The computer in the brokers office is constantly matching the orders at the best bid and offer price. Those that are not matched remain on the screen and are open for future matching during the day.

Electronic trading systems or screen-based trading has certain advantages:

1. It ensures transparency as it allows participants to see the prices of all securities in the market while business is being transacted. They

are able to see the full market during real time.

2. It increases efficiency of information being passed on, thus helping in fixing prices efficiently. The computer screens display information on prices and also capital market developments that influence share prices.
3. It increases the efficiency of operations, since there is reduction in time, cost and risk of error.
4. People from all over the country and even abroad who wish to participate in the stock market can buy or sell securities through brokers or members without knowing each other. That is, they can sit in the broker's office, log on to the computer at the same time and buy or sell securities. This system has enabled a large number of participants to trade with each other, thereby improving the liquidity of the market.
5. A single trading platform has been provided as business is transacted at the same time in all the trading centres. Thus, all the trading centres spread all over the country have been brought onto one trading platform, i.e., the stock exchange, on the computer.

Now, screen-based trading or on-line trading is the only way in which you can buy or sell shares. Shares can be held either in physical form or an electronic book entry form of holding and transferring shares can also be adopted. This electronic form is called dematerialised form.

Steps in the Trading and Settlement Procedure

It has been made compulsory to settle all trades within 2 days of the trade date, i.e., on a T+2 basis, since 2003. Prior to the reforms, securities were bought and sold, i.e., traded and all positions in the stock exchange were settled on a weekly/fortnightly settlement cycle whether it was delivery of securities or payment of cash. This system prevailed for a long time as it increased the volume of trading on the exchange and provided liquidity to the system. However, since trades were to be settled on specified dates, this gave rise to speculation and price of shares used to rise and fall suddenly due to trading and defaults by brokers. A new system, i.e, rolling settlement, was introduced in 2000, so that whenever a trade took place it would be settled after some days. Since 2003, all shares have to be covered under the rolling settlement system on a T+2 basis, meaning thereby that transactions in securities are settled within 2 days after the trade date. Since rolling settlement implies fast movement of shares, it requires effective implementation of electronic fund transfer and dematerialisation of shares.

The following steps are involved in the screen-based trading for buying and selling of securities:

1. If an investor wishes to buy or sell any security he has to first approach a registered broker or sub-broker and enter into an agreement with him. The investor has to sign a broker-client agreement and a client registration form before placing an order to buy or sell securities. He has also to provide certain other details and information. These include:
   - PAN number (This is mandatory)
   - Date of birth and address.
   - Educational qualification and occupation.
   - Residential status (Indian/NRI).
   - Bank account details.
   - Depository account details.
   - Name of any other broker with whom registered.
   - Client code number in the client registration form.

   The broker then opens a trading account in the name of the investor.
2. The investor has to open a 'demat' account or 'beneficial owner' (BO) account with a depository participant (DP) for holding and transferring securities in the demat form. He will also have to open a bank account for cash transactions in the securities market.
3. The investor then places an order with the broker to buy or sell shares. Clear instructions have to be given about the number of shares and the price at which the shares should be bought or sold. The broker will then go ahead with the deal at the above mentioned price or the best price available. An order confirmation slip is issued to the investor by the broker.
4. The broker then will go on-line and connect to the main stock exchange and match the share and best price available.
5. When the shares can be bought or sold at the price mentioned, it will be communicated to the broker's terminal and the order will be executed electronically. The broker will issue a trade confirmation slip to the investor.
6. After the trade has been executed, within 24 hours the broker issues a Contract Note. This note contains details of the number of shares bought or sold, the price, the date and time of deal, and the brokerage charges. This is an important document as it is legally enforceable and helps to settle disputes/claims between the investor and the broker. A Unique Order Code number is assigned to each transaction by the stock exchange and is printed on the contract note.
7. Now, the investor has to deliver the shares sold or pay cash for the shares bought. This should be done immediately after receiving the

contract note or before the day when the broker shall make payment or delivery of shares to the exchange. This is called the pay-in day.

8. Cash is paid or securities are delivered on pay-in day, which is before the T+2 day as the deal has to be settled and finalised on the T+2 day. The settlement cycle is on T+2 day on a rolling settlement basis, w.e.f. 1 April 2003.
9. On the T+2 day, the exchange will deliver the share or make payment to the other broker. This is called the pay-out day. The broker then has to make payment to the investor within 24 hours of the pay-out day since he has already received payment from the exchange.
10. The broker can make delivery of shares in demat form directly to the investor's demat account. The investor has to give details of his demat account and instruct his depository participant to take delivery of securities directly in his beneficial owner account.

Dematerialisation and Depositories

All trading in securities is now done through computer terminals. Since all systems are computerised, buying and selling of securities are settled through an electronic book entry form. This is mainly done to eliminate problems like theft, fake/forged transfers, transfer delays and paperwork associated with share certificates or debentures held in physical form.

This is a process where securities held by the investor in the physical form are cancelled and the investor is given an electronic entry or number so that she/he can hold it as an electronic balance in an account. This process of holding securities in an electronic form is called dematerialisation. For this, the investor has to open a demat account with an organisation called a depository. In fact, now all Initial Public Offers (IPOs) are issued in dematerialisation form and more than 99% of the turnover is settled by delivery in the demat form.

The Securities and Exchange Board of India (SEBI) has made it mandatory for the settlement procedures to take place in demat form in certain select securities. Holding shares in demat form is very convenient as it is just like a bank account. Physical shares can be converted into electronic form or electronic holdings can be reconverted into physical certificates (rematerialisation). Dematerialisation enables shares to be transferred to some other account just like cash and ensures settlement of all trades through a single account in shares. These demat securities can even be pledged or hypothecated to get loans. There is no danger of loss, theft or forgery of share certificates. It is the broker's responsibility to credit the investor's account with the correct number of shares.

Working of the Demat System

1. A depository participant (DP), either a bank, broker, or financial services company, may be identified.
2. An account opening form and documentation (PAN card details, photograph, power of attorney) may be completed.
3. The physical certificate is to be given to the DP along with a dematerialisation request form.
4. If shares are applied in a public offer, simple details of DP and demat account are to be given and the shares on allotment would automatically be credited to the demat account.
5. If shares are to be sold through a broker, the DP is to be instructed to debit the account with the number of shares.
6. The broker then gives instruction to his DP for delivery of the shares to the stock exchange.
7. The broker then receives payment and pay the person for the shares sold.
8. All these transactions are to be completed within 2 days, i.e., delivery of shares and payment received from the buyer is on a T+2 basis, settlement period.

Depository

Just like a bank keeps money in safe custody for customers, a depository also is like a bank and keeps securities in electronic form on behalf of the investor. In the depository a securities account can be opened, all shares can be deposited, they can be withdrawn/ sold at any time and instruction to deliver or receive shares on behalf of the investor can be given. It is a technology driven electronic storage system. It has no paper work relating to share certificates, transfer, forms, etc. All transactions of the investors are settled with greater speed, efficiency and use as all securities are entered in a book entry mode.

In India, there are two depositories. National Securities Depositories Limited (NSDL) is the first and largest depository presently operational in India. It was promoted as a joint venture of the IDBI, UTI, and the National Stock Exchange.

The Central Depository Services Limited (CDSL) is the second depository to commence operations and was promoted by the Bombay Stock Exchange and the Bank of India. Both these national level depositories operate through intermediaries who are electronically connected to the depository and serve as contact points with the investors and are called depository participants.

The depository participant (DP) serves as an intermediary between the investor and the Depository (NSDL or CSDL) who is authorised to maintain the accounts of dematerialised shares. Financial institutions, banks, clearing corporations, stock brokers and non-banking finance corporations are permitted to become depository participants. If the investor is buying and selling the securities through the broker or the bank or a non-banking finance corporation, it acts as a DP for the investor and complete the formalities.

National Stock Exchange of India (NSE)

The National Stock Exchange is the latest, most modern and technology driven exchange. It was incorporated in 1992 and was recognised as a stock exchange in April 1993. It started operations in 1994, with trading on the wholesale debt market segment. Subsequently, it launched the capital market segment in November 1994 as a trading platform for equities and the futures and options segment in June 2000 for various derivative instruments. NSE has set up a nationwide fully automated screen based trading system.

The NSE was set up by leading financial institutions, banks, insurance companies and other financial intermediaries. It is managed by professionals, who do not directly or indirectly trade on the exchange. The trading rights are with the trading members who offer their services to the investors. The Board of NSE comprises senior executives from promoter institutions and eminent professionals, without having any representation from trading members.

Objectives of NSE

NSE was set up with the following objectives:

a. Establishing a nationwide trading facility for all types of securities.

b. Ensuring equal access to investors all

Stock Market Index

A stock market index is a barometer of market behaviour. It measures overall market sentiment through a set of stocks that are representative of the market. It reflects market direction and indicates day-to-day fluctuations in stock prices. An ideal index must represent changes in the prices of securities and reflect price movements of typical shares for better market representation. In the Indian markets the BSE, SENSEX and NSE, NIFTY are important indices. Some important global stock market indices are:

- Dow Jones Industrial Average is among the oldest quoted stock market index in the US.
- NASDAQ Composite Index is the market capitalisation weightages of prices for stocks listed in the NASDAQ stock market.
- S and P 500 Index is made up of 500 biggest publicly traded companies in the US. The S and P 500 is often treated as a proxy for the US stock market.
- FTSE 100 consists of the largest 100 companies by full market value listed on the London Stock Exchange. The FTSE 100 is the benchmark index of the European market.

over the country through an appropriate communication network.

c. Providing a fair, efficient and transparent securities market using electronic trading system.

d. Enabling shorter settlement cycles and book entry settlements.

e. Meeting international benchmarks and standards.

Within a span of ten years, NSE has been able to achieve its objectives for which it was set up. It has been playing a leading role as a change agent in transforming the Indian capital market. NSE has been able to take the stock market to the door step of the investors. It has ensured that technology has been harnessed to deliver the services to the investors across the country at the lowest cost. It has provided a nation wide screen based automated trading system with a high degree of transparency and equal access to investors irrespective of geographical location.

Market Segments of NSE

The Exchange provides trading in the following two segments.

(i) *Whole Sale Debt Market Segment:* This segment provides a trading platform for a wide range of fixed income securities that include central government securities, treasury bills, state development loans, bonds issued by public sector undertakings, floating rate bonds, zero coupon bonds, index bonds, commercial paper, certificate of deposit, corporate debentures and mutual funds.

(ii) *Capital Market Segment:* The capital market segment of NSE provides an efficient and transparent platform for trading in equity, preference, debentures, exchange traded funds as well as retail Government securities.

Over the Counter Exchange of India (OTCEI)

The OTCEI is a company incorporated under the Companies Act 1956. It was set-up to provide small and medium companies an access to the capital market for raising finance in a cost effective manner. It was also meant to provide investors with a convenient,

Some Common Stock Market Terms

You would have often come across the following terms in magazines or newspapers when you read about the stock market.

BOURSES is another word for the stock market

BULLS and BEARS – The term does not refer to animals but to market sentiment of the investors. A Bullish phase refers to a period of optimism and a Bearish phase to a period of perssimism on the Bourses.

BADLA – This refers to a carry forward system of settlement, particularly at the BSE. It is a facility that allows the postponement of the delivery or payment of a transaction from one settlement period to another.

ODD LOT TRADING – Trading in multiples of 100 stocks or less.

PENNY STOCKS – These are securities that have no value on the stock exchange but whose trading contributes to speculation.

transparent and efficient avenue for capital market investment. It is fully computerised, transparent, single window exchange 'which commenced trading in 1992. This exchange is established on the lines of NASDAQ (National Association of Securities Dealers Automated Quotations) the OTC exchange in USA. It has been promoted by UTI, ICICI, IDBI, IFCI, LIC, GIC, SBI Capital markets and Can Bank Financial Services.

Over the counter market may be defined as a place where buyers seek sellers and vice-versa and then attempt to arrange terms and conditions for purchase/sale acceptable to both the parties. It is a negotiated market place that exists any where as opposed to the auction market place, represented by the activity on securities exchanges. Thus, in the OTC exchange, trading takes place when a buyer or seller walks up to an OTCEI counter, taps on the computer screen, finds quotes and effects a purchase or sale depending on whether the prices meet their targets. There is no particular market place in the geographical sense. The objectives of OTCEI are to provide quicker liquidity to securities at a fixed and fair price, liquidity for less traded securities or that of small companies, a simplified process of buying and selling and easy and cheaper means of making public sale of new issues. However, the OTCEI has now been withdrawn.

Advantages of OTC Market

1. It provides a trading platform to smaller and less liquid companies as they are not eligible for listing on a regular exchange.

SENSEX — The Bombay Stock Exchange Sensitive Index

Have you counted the number of times newspaper headlines in the past few weeks have been discussing the SENSEX? It goes up and down all the time and seems to be a very important part of business and economic news. Has that made you wonder what the SENSEX actually is?

The SENSEX is the benchmark index of the BSE. Since the BSE has been the leading exchange of the Indian secondary market, the SENSEX has been an important indicator of the Indian stock market. It is the most frequently used indicator while reporting on the state of the market. An index has just one job: to capture the price movement. So a stock index will reflect the price movements of shares while a bond index captures the manner in which bond prices go up or down. If the SENSEX rises, it indicates the market is doing well. Since stocks are supposed to reflect what companies expect to earn in the future, a rising index indicates that investors expect better earnings from companies. It is also a measure of the state of the Indian economy. If Indian companies are expected to do well, obviously the economy should do well too.

The SENSEX, launched in 1986 is made up of 30 of the most actively traded stocks in the market. In fact, they account for half the BSE's market capitalisation. They represent 13 sectors of the economy and are leaders in their respective industries.

2. It is a cost effective method for corporates as there is a lower cost of new issues and lower expenses of servicing the investors.
3. Family concerns and closely held companies can go public through OTC.
4. Dealers can operate both in new issues and secondary market at their option.
5. It gives greater freedom of choice to investors to choose stocks by dealers for market making in both primary and secondary markets.
6. It is a transparent system of trading with no problem of bad or short deliveries.
7. Information flows are free and more direct from market makers to customers since there is close contact between them.

BSE (Bombay Stock Exchange Ltd.)

BSE Ltd (formerly known as Bombay Stock Exchange Ltd) was established in 1875 and was Asia's first Stock Exchange. It was granted permanent recognition under the Securities Contract (Regulation) Act, 1956. It has contributed to the growth of the corporate sector by providing a platform for raising capital. It is known as BSE Ltd but was established as the Native Share Stock Brokers Association in 1875. Even before the actual legislations were enacted, BSE Ltd already had a set of Rules and Regulations to ensure an orderly growth of the securities market. As discussed earlier, a stock exchange can be set up as a corporate entity with different individuals (who are not brokers) as members or shareholders. BSE is one such exchange set up as a corporate entity with a broad shareholder base. It has the following objectives:

(a) To provide an efficient and transparent market for trading in equity, debt instruments, derivatives, and mutual funds.
(b) To provide a trading platform for equities of small and medium enterprises.
(c) To ensure active trading and safeguard market integrity through an electronically-driven exchange.
(d) To provide other services to capital market participants, like risk management, clearing, settlement, market data, and education.
(e) To conform to international standards.

Besides having a nation-wide presence, BSE has a global reach with customers around the world. It has stimulated innovation and competition across all market segments. It has established a capital market institute, called the BSE Institute Ltd, which provides education on financial markets and vocational training to a number of people seeking employment with stock brokers. The exchange has about 5000 companies listed from all over the country and outside, and has the largest market capitalisation in India.

Securities and Exchange Board of India (SEBI)

The Securities and Exchange Board of India was established by the Government of India on 12 April 1988 as an interim administrative body to promote orderly and healthy growth of securities market and for investor protection. It was to function under the overall administrative control of the Ministry of Finance of the Government of India. The SEBI was given a statutory status on 30 January 1992 through an ordinance. The ordinance was later replaced by an Act of Parliament known as the Securities and Exchange Board of India Act, 1992.

Reasons for the Establishment of SEBI

The capital market has witnessed a tremendous growth during 1980's, characterised particularly by the increasing participation of the public. This ever expanding investors population and market capitalisation led to a variety of malpractices on the part of companies, brokers, merchant bankers, investment consultants and others involved in the securities market. The glaring examples of these malpractices include existence of self – styled merchant bankers unofficial private placements, rigging of prices, unofficial premium on new issues, non-adherence of provisions of the Companies Act, violation of rules and regulations of stock exchanges and listing requirements, delay in delivery of shares etc. These malpractices and unfair trading practices have eroded investor confidence and multiplied investor grievances. The Government and the stock exchanges were rather helpless in redressing the investor's problems because of lack of proper penal provisions in the existing legislation. In view of the above, the Government of India decided to set-up a separate regulatory body known as Securities and Exchange Board of India.

Purpose and Role of SEBI

The basic purpose of SEBI is to create an environment to facilitate efficient mobilisation and allocation of resources through the securities markets. It also aims to stimulate competition and encourage innovation. This environment includes rules and regulations, institutions and their interrelationships, instruments, practices, infrastructure and policy framework.

This environment aims at meeting the needs of the three groups which basically constitute the market, viz, the issuers of securities (Companies), the investors and the market intermediaries.

- To the issuers, it aims to provide a market place in which they can confidently look forward to raising finances they need in an easy, fair and efficient manner.
- To the investors, it should provide protection of their rights and interests through adequate, accurate and authentic information and disclosure of information on a continuous basis.

- To the intermediaries, it should offer a competitive, professionalised and expanding market with adequate and efficient infrastructure so that they are able to render better service to the investors and issuers.

Objectives of SEBI

The overall objective of SEBI is to protect the interests of investors and to promote the development of, and regulate the securities market. This may be elaborated as follows:

1. To regulate stock exchanges and the securities industry to promote their orderly functioning.
2. To protect the rights and interests of investors, particularly individual investors and to guide and educate them.
3. To prevent trading malpractices and achieve a balance between self regulation by the securities industry and its statutory regulation.
4. To regulate and develop a code of conduct and fair practices by intermediaries like brokers, merchant bankers etc., with a view to making them competitive and professional.

Functions of SEBI

Keeping in mind the emerging nature of the securities market in India, SEBI was entrusted with the twin task of both regulation and development of the securities market. It also has certain protective functions.

Regulatory Functions

1. Registration of brokers and sub-brokers and other players in the market.
2. Registration of collective investment schemes and Mutual Funds.
3. Regulation of stock brokers, portfolio exchanges, underwriters and merchant bankers and the business in stock exchanges and any other securities market.
4. Regulation of takeover bids by companies.
5. Calling for information by undertaking inspection, conducting enquiries and audits of stock exchanges and intermediaries.
6. Levying fee or other charges for carrying out the purposes of the Act.
7. Performing and exercising such power under Securities Contracts (Regulation) Act 1956, as may be delegated by the Government of India.

Development Functions

1. Training of intermediaries of the securities market.
2. Conducting research and publishing information useful to all market participants.
3. Undertaking measures to develop the capital markets by adapting a flexible approach.

Protective Functions

1. Prohibition of fraudulent and unfair trade practices like making misleading statements, manipulations, price rigging etc.
2. Controlling insider trading and imposing penalties for such practices.

3. Undertaking steps for investor protection.
4. Promotion of fair practices and code of conduct in securities market.

The Organisation Structure of SEBI

As SEBI is a statutory body there has been a considerable expansion in the range and scope of its activities. Each of the activities of the SEBI now demands more careful, closer, co-ordinated and intensive attention to enable it to attain its objectives. Accordingly, SEBI has been restructured and rationalised in tune with its expanded scope. It has decided its activities into five operational departments. Each department is headed by an executive director. Apart from its head office at Mumbai, SEBI has opened regional offices in Kolkalta, Chennai, and Delhi to attend to investor complaints and liaise with the issuers, intermediaries and stock exchanges in the concerned region.

The SEBI also formed two advisory committees. They are the Primary Market Advisory Committee and the Secondary Market Advisory Committee. These committees consist of the market players, the investors associations recognised by the SEBI and the eminent persons in the capital market. They provide important inputs to the SEBI's policies.

The objectives of the two Committees are as follows:

a. To advise SEBI on matters relating to the regulation of intermediaries for ensuring investors protection in the primary market.
b. To advise SEBI on issues related to the development of primary market in India.

SEBI Violations

SEBI on Thursday unearthed yet another abuse of IPO norms in the IDFC's Initial Public Offering (IPO) where a few investors opened over 14,000 dematerialised accounts to corner large number of shares of the company.

This is the second such incident, after a similar such violations were detected in the YES Bank's IPO.

SEBI said in IDFC's IPO too four investors opened as many as 14,807 dematerialised accounts with Karvy-DP and 'Strangely', all these account holders have their bank accounts with Bharat Overseas Bank Ltd., Ahmedabad.

SEBI order said: "Further probe is required for examining the systemic fault, if any, of the registrar Karvy-RTI, i.e., Karvy Computer Shares P Ltd., and the lead managers Kotak Mahindra Capital Company Ltd., DSP Merrill Lynch Ltd. and SBI Capital Markets Ltd. in identifying and weeding out the *benami* applications."

Reference is being made to the RBI to examine the role of BOB, HDFC Bank, Indian Overseas Bank, ING Vysya Bank and Vijaya Bank in opening the bank accounts of these *benami* entities and apparently funding them.

Source: The Economic Times

c. To advise SEBI on disclosure requirements for companies.

d. To advise for changes in legal framework to introduce simplification and transparency in the primary market.

e. To advise the board in matters relating to the development and regulation of the secondary market in the country.

The committees are however non-statutory in nature and the SEBI is not bound by the advise of the committee. These committees are a part of SEBI's constant endeavor to obtain a feedback from the market players on various issues relating to the regulations and development of the market.

KEY TERMS

Financial Market	Money Market	Treasury Bills
Commercial Paper	Call Money	Certificate of Deposit
Commercial Bill	Money Market	Mutual Fund Capital
Market	Primary Market	Secondary Market
Stock Exchange	SEBI, NSE	OTCEI

SUMMARY

Financial Market is a market for creation and exchange of financial assets. It helps in mobilisation and channelising the savings into most productive uses. Financial markets also helps in price discovery and provide liquidity to financial assets.

Money Market is a market for short-term funds. It deals in monetory assets whose period of maturity is less than one year. The instruments of money market includes treasury bills, commercial paper, call money, Certificate of deposit, commercial bills, participation certificates and money market mutual funds.

Capital Market is a place where long-term funds are mobilised by the corporate undertakings and Government. Capital Market may be devided into primary market and secondary market. Primary market deals with new securities which were not previously tradable to the public. Secondary market is a place where existing securities are bought and sold.

Stock Exchanges are the organisations which provide a platform for buying and selling of existing securities. Stock exchanges provide continuous market for securities, helps in price discovery, widening share ownership and provide scope for speculation.

The National Stock Exchange of India is the latest, most modern and technology driven exchange and was incorporated in 1992. OTCEI was incorporated in

1992 to provide listing facility for small companies with paid up capital of less than 3 crores.

Securities and Exchange Board of India was established in 1988 and was given statutory status through an Act in 1992. The SEBI was set-up to protect the interests of investors, development and regulation of securities market.

EXERCISES

Multiple choice questions

1. Primary and secondary markets:
   a. Compete with each other
   b. Complement each other
   c. Function independently
   d. Control each other
2. The total number of Stock Exchanges in India is:
   a. 20 b. 21 c. 22 d. 23
3. The settlement cycle in NSE is:
   a. T + 5 b. T + 3 c. T + 2 d. T+1
4. The National Stock Exchange of India was recognized as stock exchange in the year:
   a. 1992 b. 1993 c. 1994 d. 1995
5. NSE commenced futures trading in the year:
   a. 1999 b. 2000 c. 2001 d. 2002
6. Clearing and settlement operations of NSE are carried out by:
   a. NSDL b. NSCCL c. SBI d. CDSL
7. OTCEI was started on the lines of:
   a. NASDAQ b. NYSE c. NASAQ d. NSE
8. To be listed on OTCEI, the minimum capital requirement for a company is:
   a. Rs. 5 crores b. Rs. 3 crores c. Rs. 6 crores d. Rs. 1 crore
9. A Treasury Bill is basically:
   a. An instrument to borrow short-term funds
   b. An instrument to borrow long-term funds
   c. An instrument of capital market
   d. None of the above

Short answer questions

1. What are the functions of a financial market?
2. “Money Market is essentially a Market for short term funds.” Discuss.
3. What is a Treasury Bill ?
4. Distinguish between Capital Market and Money Market.
5. What are the functions of a Stock Exchange?
6. What are the objectives of the SEBI?
7. State the objectives of the NSE.
8. What is the OTCEI?

Long–answer questions

1. Explain the various Money Market Instruments.
2. What are the methods of floatation in Primary Market?
3. Explain the recent Capital Market reforms in India.
4. Explain the objectives and functions of the SEBI
5. Explain the various segments of the NSE.

Projects and Assignments

1. Collect the information about the companies that have recently mobilised resources through primay market.
2. Collect the information on various measures taken by SEBI to protect the interests of investors since its inception.
3. Send a group of students to a trading terminal in your city to gain first hand information on securities trading and prepare a report.
4. Collect data about the movements in SENSEX and NIFTY during the last one month. Find out whether the two move in same or opposite direction.
5. Collect information about the SEBI action for Investor Protection taken during last two years.
6. Collect information about e-IPO’s in the Indian Market in the last one year.

TRY AND SOLVE THE CROSSWORD

Clues to the Crossword

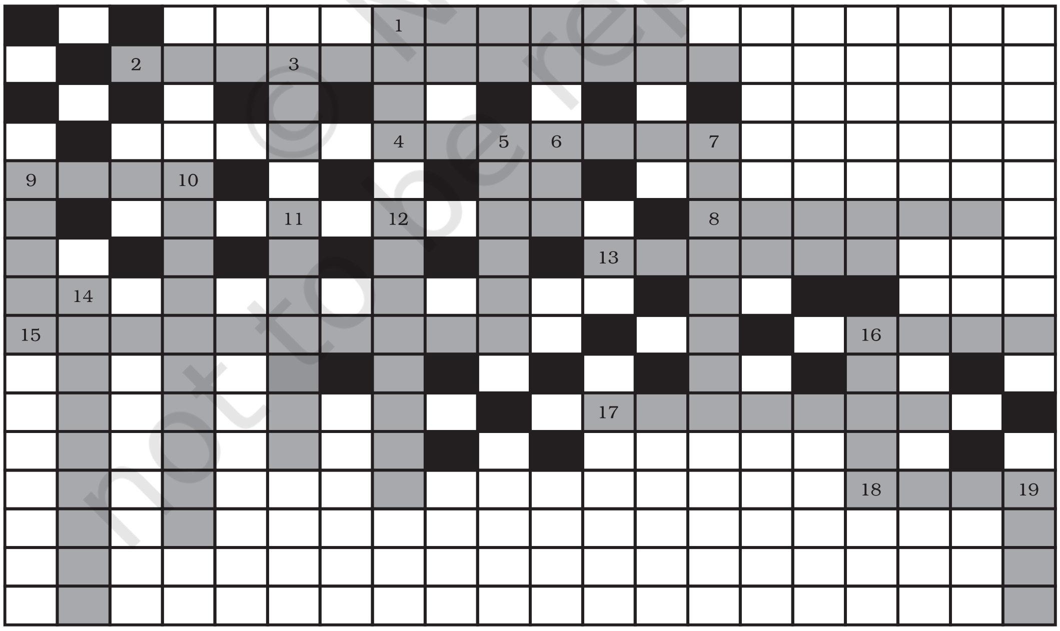
Across

1. Commission Agent who transacts in securities on behalf of non members or members (6).
2. Changes in the price of securities in the stock market. (12)
4. Inclusion of securities in the official trade list of securities in stock market (7)
8. Place of trade I securities (6)
9. Result of selling shares at a price lower than the purchase price. (4)

13. An independent dealer in securities (6)
15. Includes shares, scripts, bonds, debentures (10)
16. Speculator who expects the prices to go down (4)
17. Buying and selling of securities to manipulate the market (7)
18. Speculator who deals in new securities only (4)

Down

1. Speculator expecting a rise in the prices (4)
3. Means 'with' (3)
5. Means a part or fraction of capital (6)
6. Fraction of profit paid to government (3)
7. Illegal, game based on chance (8)
9. Official statement of securities in the stock market (5)
10. Those who buy and sell securities with objective of profit (10)
11. Money invested in business (7)
12. Return on shares out of profits (8)
14. Instrument acknowledging a debt (9)
16. Govt. document acknowledging a debt (5)
19. Profit or yield (4)



Case Problem I

'R' Limited is a real estate company which was formed in 1950. In about 56 years of its existence the company has managed to carve out a niche for itself in this sector. Lately, this sector is witnessing a boom due to the fact that the Indian economy is on the rise. The incomes of middle class are rising. More people can afford to buy homes for themselves due to easy availability of loans and accompanying tax concessions.

To expand its business in India and abroad the company is weighing various options to raise money through equity offerings in India. Whether to tap equity or debt. market whether to raise money from domestic market or international market or Combination of both? Whe their to raise the necessary financé from money market or capital market. It is also planning to list itself in New York Stock Exchange to raise money through ADR's. To make its offerings attractive it is planning to offer host of financial plans products to its stakeholders and investors and also expand it's listing at NSE after complying with the regulations of SEBI.

(i) What benefits will the company derive from listing at NSE?

(ii) What are the regulations of SEBI that the company must comply with?

(iii) How does the SEBI exercise control over 'R' Limited in the interest of investors?

Case Problem II

NSE Indices

Index	Current	Prev.	%CHG
S&P CNX Nifty	3641.1	3770.55	-3.43%
CNX Nifty Junior	6458.55	6634.85	-2.66%
CNX IT	5100.5	5314.05	-4.02%
Bank Nifty	5039.05	5251.55	-4.05%
CNX 100	3519.35	3640.35	-3.32%
More			

World Markets

Index	Current	Prev.	% Change
NYSE Composite	8926.88	9120.93	-2.13%
NASDAQ Composite	2350.57	2402.29	-2.15%
DOW Jones I. A.	12076	12318.6	-1.97%
S&P 500	1377.95	1406.6	-2.04%
Nikkei 225	16676.9	17178.8	-2.92%

Source: www.nseindia.com

The above figures are taken from the website of national stock exchange of India. They illustrate the movement of NSE stock indices as well as world stock indices on the date indicated.

Questions

1. What do you mean by a stock index? How is it calculated?
2. What conclusions can you draw from the various movements of NSE stock indices?
3. What factors affect the movement of stock indices? Elaborate on the nature of these factors.

4. What relationship do you see between the movement of indices in world markets and NSE indices?
5. Give details of all the indices mentioned above. You can find information on the web or business magazines.

   (The teacher should help the students in answering these questions. They can look at the website mentioned above and also website of SEBI, i.e., www.sebi.gov.in for educational material. This exercise will help the students in understanding the stock markets clearly and also create interest therein.)

Project Work

1. Study the wwebsite of Mumbai Stock Exchange, i.e., www.bseindia.com and compile information which you find useful. Discuss it in your class and find out how it can help you should you decide to invest in the stock market. Prepare a report on your findings with the help of your teacher.
2. Prepare a report on the role of SEBI in regulating the Indian stock market. You can get this information on its website namely www.sebi.gov.in. Do you think something else should be done to increase the number of investors in the stock market?

Answers to the Crossword

Across	1. Broker	2. Fluctuations	4. Listing	8. Market	9. Loss
	13. Jobber	15. Securities	16. Bear	17. Rigging	18. Stag
Down	1. Bull	3. Cum	5. Stocks	6. Tax	7. Gambling
	9. Lists	10. Speculator	11. Capital	12. Dividend	14. Debenture
	16. Bonds	19. Gain			

CHAPTER 11

MARKETING

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- explain the meaning of 'marketing';
- distinguish between 'marketing' and 'selling';
- list out important functions of marketing;
- examine the role of marketing in the development of an economy in a firm, to the society and to consumers;
- explain the elements of marketing-mix;
- classify products into different categories;
- analyse the factors affecting price of a product;
- list out the types of channels of distribution; and
- explain the major tools of promotion, viz. advertising, personal selling, sales promotion and publicity.

WHERE DO COMPANIES DO THEIR BUSINESS?

In the Markets or in the Society?

It is an undisputed fact that a company's survival does not depend upon its consumers alone, but a diverse set of stakeholders like the government, religious leaders, social activists, NGOs, media, etc. Hence, earning the satisfaction of these segments is also as imperative as they add to the power of the brand by word of mouth.

The social concern adds to the strength of the brand. Corporates that embraced the deepest social values, have been successful in building powerful brand, and, eventually, robust customer relationship. The area of corporate social justice fall under two broad categories. The issues such as the nutrition of children, child care, old-age homes, amelioration of hunger, offering aid to those affected by natural calamities, etc. needing instant attention with humanitarian perspective, comes under the first category.

The issues that contribute to making society a pleasant place to live in the long run, may be grouped under the second category. The issues which come under this category are health awareness and aid, education, environmental protection, women's employment and empowerment, preventing unjust discriminations (on the basis of caste, community, religion, ethnicity, race, and sex), eradication of poverty through employment, preservation of culture, values, and ethics, contribution to research, etc.

Infosys Technologies, the leading software consulting service provider, has been certified ISO 14001, compliant by Det Norske Veritas for its development centers in Pune, Chennai, Bangalore, Bhubaneshwar, Hyderabad, Mangalore, Mohali, and Mysore, for its 'Ozone Initiative'. Through this initiative, Infosys has committed for continual improvement.

Procter and Gamble's (P&G) philosophy is that it should lead the industry in implementing a global environmental programme. P&G is one of the first companies in the world to actively study the influence of consumer products on the environment and introduce concentrated products, recycled plastic bottles, and refill packages to the industry. The overall packaging per case has been reduced by an average of 27% and a reduction of 37% in air, waste, and water emissions has been achieved consistently since 1990. P&G contributes to sustainable development and addresses environmental and social issues connected with its products and services.

Source: Adapted from 'Effective Executive', Feb. 2006

Let us consider a typical day in our life. Right from the time we get up in the morning to the time we go to bed, we use number of products to satisfy our different needs. Beginning with the breakfast, we take such items as bread, butter, milk, and rice, to satisfy our hunger; use the services of a bus or an auto or a cycle to reach to our school or place of work; read books, magazines and newspapers, to keep ourselves informed and acquire knowledge; use computers, cell phone, television and other gadgets for communication/ entertainment; and purchase many other products like gifts, shoes, clothing, furniture, etc., from market to satisfy our different needs.

Who makes these products and why? These products are manufactured and marketed by different firms. For example, Lifebouy soap, Closeup toothpaste, Surf detergent powder are manufactured by Hindustan Lever; Ariel detergent powder by Procter and Gamble, Dairy Milk Chocolate by Nestle, Atlas Cycles by Atlas cycle company, Kwality Ice-creams by Kwality Walls, LG Televisions by LG Electronics and so on. These firms are called marketers. These firms undertake various activities to stimulate the demand for their products and earn profit by satisfying customer's needs and wants. People purchase products because these satisfy some of their needs.

Number of activities are performed by the marketers to facilitate exchange of goods and services between producers and the users of such products. These activities are referred to as marketing activities.

For a proper understanding of marketing, number of questions need to be answered. These include: What do we mean by a market? What can be marketed? Is it products or services or something more? Who is a marketer? What is marketing management? These points have been taken up for discussion in the following sections.

> "Business is not financial science, it's about trading, buying and selling. It's about creating a product or service so good that people will pay for it."
>
> — **Anta Roddick**
>
> "Marketing takes a day to learn. Unfortunately it takes time to master."
>
> — **Philip Kotler**

What is a Market

In the traditional sense, the term 'market' refers to the place where buyers and sellers gather to enter into transactions involving the exchange of goods and services. It is in this sense that this term is being used in day to day language, even today. The other ways in which this term is being used is in the context of a *product market* (cotton market, gold or share market), *geographic market* (national and international market), *type of buyers* (consumer market and industrial market) and the *quantity of goods transacted* (retail market and wholesale market).

But in modern marketing sense, the term market has a broader meaning. It refers to a set of actual and potential buyers of a product or service. For example, when a fashion designer designs a new dress and offers it for exchange, all the people who are willing to buy and offer some value for it can be stated to be the market for that dress. Similarly, market for fans or bicycles or electric bulbs or shampoos refers to all the actual and potential buyers for these products.

What is Marketing

The term marketing has been described by different people in different ways. Some people believe that marketing is same as 'shopping'. Whenever they go out for shopping of certain products or services, they describe it as marketing. There are some other people who confuse marketing with 'selling' and feel that marketing activity starts after a product or service has been produced. Some people describe it to mean 'merchandising' or designing a product. All these descriptions may be partly correct but marketing is a much broader concept, which is discussed as follows:

Traditionally, marketing has been described in terms of its functions or activities. In this respect, marketing has been referred to as performance of business activities that direct the flow of goods and services from producers to consumers.

As we know, most of the manufacturing firms do not produce goods for their own consumption but for the consumption or use by others. Therefore, to move the goods and services from the producer to consumers, a number of activities, such as product designing or merchandising, packaging, warehousing, transportation, branding, selling, advertising and pricing are required. All these activities are referred to as marketing activities.

Thus, 'merchandising', 'selling' and distribution are all parts of a large number of activities undertaken by a firm, which are collectively called marketing.

It may be noted here that marketing is not merely a post-production activity. It includes many activities that are performed even before goods are actually produced, and continue even after the goods have been sold. For example, activities such as identification of customer needs, collection of information for developing the product, designing suitable product package and giving it a brand name are performed before commencement of the actual production. Similarly, many follow up activities are required for maintaining good customer relations for procuring repeat sale.

In modern times, emphasis is placed on describing marketing as a social process. It is a process whereby people exchange goods and services for money or for something of value to them. Taking the social perspective, Phillip Kolter has defined marketing as, "a social process by which individual groups obtain what they need and want through creating offerings and freely exchanging products and services of value with others".

Thus, marketing is a social process where in people interact with others, in order to persuade them to act in a particular way, say to purchase a product or a service, rather than forcing them to do so. A careful analysis of the definition shows the following important features of marketing:

1. Needs and Wants: The process of marketing helps individuals and groups in obtaining what they need and want. Thus, the primary reason or motivation for people to engage in the process of marketing is to satisfy some of their needs or wants. In other words, the focus of the marketing process is on satisfaction of the needs and wants of individuals and organisations.

A need is a state of felt deprivation or feeling of being deprived of something. If unsatisfied, it leaves a person unhappy and uncomfortable. For example, on getting hungry, we become uncomfortable and start looking for objects that are capable of satisfying our hunger.

Needs are basic to human beings and do not pertain to a particular product. Wants, on the other hand, are culturally defined objects that are potential satisfiers of needs. In other words, human needs shaped by such factors as culture, personality and religion are called wants. A basic need for food, for example, may take various forms such as want for *dosa* and *rice* for a South Indian and *chapatti* and *vegetables* for a North Indian person.

A marketer's job in an organisation is to identify needs of the target customers and develop products and services that satisfy such needs.

2. Creating a Market Offering: On the part of the marketers, the effort involves creation of a 'market offering. Market offering refers to a complete offer for a product or service, having given features like size, quality, taste, etc; at a certain price; available at a given outlet or location and so on. Let us say the offer is for a cell phone, available in four different versions, on the basis of certain features such as size of memory, television viewing, internet, camera, etc., for a given price, say between Rs. 5,000 and Rs. 20,000 (depending on the model selected), available for sale at say firm's exclusive shops in and around all metropolitan cities in the country. A good 'market offer' is the one which is developed after analysing the needs and preferences of the potential buyers.

3. Customer Value: The process of marketing facilitates exchange of products and services between the buyers and the sellers. The buyers, however, make buying decisions on their perceptions of the value of the product or service in satisfying their need, in relation to its cost. A product will be purchased only if it is perceived to be giving greatest benefit or value for the money. The job of a marketer, therefore, is to add to the value of the product so that the customers prefer it in relation to the competing products and decide to purchase it.

4. Exchange Mechanism: The process of marketing works through the exchange mechanism. The individuals (buyers and sellers) obtain what they need and want through the process of exchange. In other words, the process of marketing involves exchange of products and services for money or something considered valuable by the people.

Exchange refers to the process through which two or more parties come together to obtain the desired product or service from someone, offering the same by giving something in return. For example, a person feeling hungry may get food by offering to give money or some other product or service in return to someone who is willing to accept the same for food.

In the modern world, goods are produced at different places and are distributed over a wide geographical area through various middlemen, involving exchanges at different levels of distribution. Exchange is, therefore, referred to as the essence of marketing. For any exchange to take place, it is important that the following conditions are satisfied:

(i) involvement of at least two parties viz., the buyer and the seller.

(ii) each party should be capable of offering something of value to the other. For example, the seller offers a product and the buyer, money.

(iii) each party should have the ability to communicate and deliver the product or service. No exchange can take place if the buyers and sellers are not able to communicate with each other or if they can not deliver something of value to the other.

(iv) each party should have freedom to accept or reject other party's offer.

(v) the parties should be willing to enter into transaction with each other. Thus, the acceptance or rejection of the offer takes place on voluntary basis rather than on the bases of any compulsion.

The points listed above are the necessary conditions for an exchange to take place. Whether the exchange actually takes place or not depends on the suitability of the act of exchange to both the parties, whether it makes the parties better off or at least not worse off.

Another important point to be noted is that Marketing is not merely a business phenomena or confined only to business organisations. Marketing activities are equally relevant to non-

What can be Marketed?

Physical Products	:	DVD player, Motor cycle, ipods, Cell phone, Footwear, Television, Refrigerator.
Services	:	Insurance, Health Care, Business Process Outsourcing, Security, Easy Bill service, Financial Services (Investment),Computer Education, Online Trading.
Ideas	:	Polio Vaccination, Helpage, Family Planning, Donation of Blood (Red cross), Donation of money on Flag Day (National Foundation for Communal Harmony).
Persons	:	For Election of Candidates for Certain Posts.
Place	:	'Visit Agra – 'City of Love', 'Udaipur – 'The City of Lakes', 'Mysore – The City of Gardens', 'When Orisa celebrates, Eleven the God Join In'.
Experience	:	Customised Experiences as Dinner with a cricketer (say Dhoni); Lunch with a celebrity (say Bill Gates or Aishwarya Roy) or experience of Baloon Riding, mountaineering, etc.
Properties	:	Intangible rights of ownership of real estate in financial property (Shares, Debentures).
Events	:	Sports events (say Olympics, Cricket series), diwali mela, fashion show, music concert, film festival, elephant race (Kerala Tourism).
Information	:	Production packaging and distribution of information by organisations such as by universities, research organisation, providing information as market information (marketing research agencies), technology information.
Organisations	:	For boosting their public image organisations such as Hindustan Lever, Ranbaxy, Dabur, Proctor and Gamble, communicate with people. Example, Phillips says, Let's make Things Better'.

profit organisations such as hospitals, schools, sports clubs and social and religious organisations. It helps these organisations in achieving their goals such as spreading the message of family planning, improving the literacy standards of people and providing medication to the sick.

What can be marketed?

The question commonly coming to the mind is what can be marketed. Is it a product or service or something else. Let us first understand what is a product?

A product is a 'bundle of utilities' or 'source of satisfaction', that can be used to satisfy human needs and wants. It is not confined to physical objects, such as motor cycle, biscuit, bulb and pencil but also refers to other things of value such as services, ideas, places, etc., that can be offered to the potential buyers for their use. In the marketing literature, anything that can be of value to the buyer can be termed as a 'product'. It can be tangible, i.e., which can be felt, seen and touched physically such as a pencil, a cycle or an intangible such as services rendered by a doctor, hairdresser or a lawyer.

Apart from the product, what can be marketed is a service or a person (say political parties persuading to vote for a particular candidate) or an idea (say Red Cross persuading to donate blood) or a place (say Kerala Tourism persuading people to visit Kerala for health tourism). Thus, anything that is of value to the other can be marketed. It can be a product or a service or a person or a place or an idea or an event or an organisation or experience or properties. (see box)

Who is a marketer? Marketer refers to any person who takes more active part in the process of exchange. Normally it is the seller who is more active in the exchange process as he/she analyses the needs of the potential buyers, develops a market offering and persuades the buyers to buy the product. However, there may be certain situations where the buyer may be taking more active role in the exchange process. Let us say in situations of rare supply, the buyer may be taking extra efforts in persuading the seller to sell the product to him/her. This may be happening in defence deals or take a situation where a country having installed a nuclear plant needs the supply of nuclear fuel or 'Heavy Water'. It may need to convince the supplier of the products to supply the same to it, by promising that it will be used for peaceful purposes only. In this case, the buyer will be treated as the marketer. Thus, any body, who takes

Do it yourself

Collect five advertisements each for the marketing of (a) ideas and (b) places from a newspaper or a magazine. Write in your notebook, the messages conveyed through these and discuss in the class indicating which of these messages are more appealing to you. Give reasons in support of your answer.

more active role in the exchange process will be taken as the marketer.

Marketing Management

Marketing management means management of the marketing function. In other words, marketing management refers to planning, organising, directing and control of the activities which facilitate exchange of goods and services between producers and consumers or users of products and services. Thus the focus of marketing management is on achieving desired exchange outcomes with the target markets. Taking a management perspective, the term marketing has been defined as "the process of planning and executing the conception, pricing, promotion and distribution of ideas, goods and services to create exchanges that satisfy individual and organisational goals" by American Management Association, similarly Philip Kotler has defined Marketing management as the art and science of choosing target markets and getting, keeping and growing customers through creating, delivering and communicating superior customer values of management.

A careful analysis of the definition reveals that the process of management of marketing involves:

(i) Choosing a target market, say a manufacturer may choose to make readymade garments for children up to the age of 5 years;

(ii) In respect of the target market chosen, the focus of the process of management is on getting, keeping as well as growing the customers. That means the marketer has to create demand for his products so that the target customers purchase the product, keep them satisfied with the firm's products and also attract more customers to the firm's products so that the firm can grow; and

(iii) The mechanism for achieving the objective is through creating, developing and communicating superior values for the customers. That means, the primary job of a marketing manager is to create superior values so that the customers are attracted to the products and services and communicate these values to the prospective buyers and persuade them to buy these products.

Marketing management involves performance of various functions such as analysing and planning the marketing activities, implementing marketing plans and setting control mechanism. These functions are to be performed in such a way that organisation's objectives are achieved at the minimum cost.

Marketing management generally is related to creation of demand. However, in certain situations, the manager has to restrict the demand. For example, if there is a situation of 'overfull demand', i.e., the demand being more than what the company can or want to handle, (like what the situation in our country was before the adoption of policies of liberalisation and globalisation, in early 90's, in most consumer products be it automobiles or electronics goods or other durable products. The job of marketing mangers, in these situations would be to find ways to reduce the demand temporarily by say reducing the expenditure on promotion or increasing the prices. Similarly, if the demand is 'irregular', such as in case of seasonal products, (say fans, woollen clothes) the marketer's job is to change the time pattern of demand through such methods as providing short-term incentives, to the buyers. Thus, the marketing management in not only concerned with creating demand but with managing the demand effectively, as per the situation in the market.

Marketing and Selling

Many people confuse 'selling' for 'marketing'. They consider these two terms as one and the same. Marketing refers to a large set of activities of which selling is just one part. For example, a marketer of televisions, before making the sale, does a lot of other activities such as planning the type and model of televisions to be produced, the price at which it would be sold and selecting the distribution outlets at which the same would be available, etc. In short, marketing involves whole range of activities relating to planning, pricing, promoting and distributing the products that satisfy customer's needs.

The function of selling, on the other hand, is restricted to promotion of goods and services through salesmanship, advertising, publicity and short-term incentives so that title of the product is transferred from seller to buyer or in other words product is converted into cash.

The major differences between selling and marketing are listed as below:

(i) *Part of the Process vs Wider Term:* Selling is only a part of the process of marketing and is concerned with promoting and transferring possession and ownership of goods from the seller to the buyer. Marketing is a much wider term consisting of number of activities such as identification of the customer's needs, developing the products to satisfy these needs, fixing prices and persuading the potential buyers to buy the same. Thus, selling is merely a part of marketing.

(ii) *Transfer of Title vs Satisfying Customer Needs:* The main focus of selling is on affecting transfer of title and possession of goods from sellers to consumers or users. In contrast, marketing activities put greater thrust on achieving maximum satisfaction of the customer's needs and wants.

(iii) *Profit through Maximising Sales vs Customer Satisfaction:* All selling activities are directed at maximising sales and, thereby, the profits of the firm. In other words, the emphasis is on profit maximisation through maximisation of sales. Marketing, on the other hand, is concerned with customer satisfaction and thereby increasing profit in the long run. A marketing organisation, thus, attaches highest importance to customer satisfaction as a route to profit maximisation.

(iv) *Start and End of the Activities:* Selling activities start after the product has been developed while, marketing activities start much before the product is produced and continue even after the product has been sold.

(v) *Difference in the Emphasis:* In selling, the emphasis is on bending the customer according to the product while in marketing, the attempt is to develop the product and other strategies as per the customer needs.

vi. *Difference in the Strategies:* Selling involves efforts like promotion and persuasion while marketing uses integrated marketing efforts involving strategies in respect of product, promotion, pricing and physical distribution.

Marketing Management Philosophies

In order to achieve desired exchange outcomes with target markets, it is important to decide what philosophy or thinking should guide the marketing efforts of an organisation. An understanding of the philosophy or the concept to be adopted is important as it determines the emphasis or the weightage to be put on different factors, in achieving the organisational objectives. For example, whether the marketing efforts of an organisation will focus on the product—say designing its features etc or on selling techniques or on customer's needs or the social concerns.

The concept or philosophy of marketing has evolved over a period of time, and is discussed as follows.

The Production Concept

During the earlier days of industrial revolution, the demand for industrial goods started picking up but the number of producers were limited. As a result, the demand exceeded the supply. Selling was no problem. Anybody who could produce the goods was able to sell. The focus of business activities was, therefore, on production of goods. It was believed that profits could be maximised by producing at large scale, thereby reducing the average cost of production. It was also assumed that consumers would favour those products which were widely available at an affordable price. Thus, availability and affordability of the product were considered to be the key to the success of a firm. Therefore, greater emphasis was placed on improving the production and distribution efficiency of the firms.

The Product Concept

As a result of emphasis on production capacity during the earlier days, the position of supply increased over period of time. Mere availability and low price of the product could not ensure increased sale and as such the survival and growth of the firm. Thus, with the increase in the supply of the products, customers started looking for products which were superior in quality, performance and features. Therefore, the emphasis of the firms shifted from quantity of production to quality of products. The focus of business activity changed to bringing continuous improvement in the quality, incorporating new features etc. Thus, product improvement became the key to profit maximisation of a firm, under the concept of product orientation.

The Selling Concept

With the passage of time, the marketing environment underwent further change. The increase in the scale of business further improved the position with respect to supply of goods, resulting in increased competition among sellers. The product quality and availability did not ensure the survival and growth of firms because of the large number of sellers selling quality products. This led to greater importance to attracting and persuading customers to buy the product. The business philosophy changed. It was assumed that the customers would not buy, or not buy enough, unless they are adequately convinced and motivated to do so. Therefore, firms must undertake aggressive selling and promotional efforts to make customers buy their products. The use of promotional techniques such as advertising, personal selling and sales promotion were considered essential for selling of products. Thus, the focus of business firms shifted to pushing the sale of products through aggressive selling techniques with a view to persuade, lure or coax the buyers to buy the products. Making sale through any means became important. It was assumed that buyers can be manipulated but what was forgotten was that in the long run what matters most is the customer satisfaction, rather than anything else.

The Marketing Concept

Marketing orientation implies that focus on satisfaction of customer's needs is the key to the success of any organisation in the market. It assumes that in the long run an organisation can achieve its objective of maximisation of profit by identifying the needs of its present and prospective buyers and satisfying them in an effective way. All the decisions in a firm are taken from the point of view of the customers. In other words, customer's satisfaction become the focal point of all decision making in the organisation. For example, what product will be produced, with what features and at what price shall it be sold, or where shall it be made available for sale will depend on what do the customers want. If the customers want features like double door in a refrigerator or a separate provision for water cooler in it, the organisation would produce a refrigerator with these features, would price it at a level which the customers

Differences in the Marketing Management Philosophies

Philosophies/ Bases	Production Concept	Product Concept	Selling Concept	Marketing Concept	Societal Concept
1. Starting Point	Factory	Factory	Factory	Market	Market, Society
2. Main Focus	Quantity of product	Quality, performance, features of product	Existing product	Customer needs	Customer needs and society's well being
3. Means	Availability and affordability of product	Product improve-ments	Selling and promoting	Integrated marketing	Integrated marketing
4. Ends	Profit through volume of production	Profit through product quality	Profit through sales volume	Profit through customer satisfaction	Profit through customer satisfaction and social welfare

are willing to pay and so on. If all marketing decisions are taken with this prospective, selling will not be any problem. It will automatically follow. The basic role of a firm then is to 'identify a need and fill it'. The concept implies that products ad-services are bought not merely because of their quality, packing or brand name, but because they satisfy a specific need of a customer. A pre-requisite for the success of any organisation, therefore, is to understand and respond to customer needs.

Test Your Understanding I

State whether the following statements are true or false:

(i) focus of marketing activities is on facilitating exchange of goods from producers to consumers or users;

(ii) in modern marketing, the term market refers to the place where buyers and sellers meet for the exchange of goods and services;

(iii) marketing is same thing as shopping for goods and services;

(iv) marketing is a post production activity only;

(v) marketing is equally relevant to non-profit organisations;

(vi) The terms 'need' and 'want' are used interchangeably in the marketing literature;

(vii) marketing management means management of the marketing function; and

(viii) Product designing does not come under the purview of marketing activities.

To sum up, the marketing concept is based on the following pillars:

(i) Identification of market or customer who are chosen as the target of marketing effort.

(ii) Understanding needs and wants of customers in the target market.

(iii) Development of products or services for satisfying needs of the target market.

(iv) Satisfying needs of target market better than the competitors.

(v) Doing all this at a profit.

Thus, the focus of the marketing concept is on customer needs and the customer satisfaction becomes the means to achieving the firms' objective of maximising profit. The purpose of marketing is to generate customer value at a profit.

The Societal Marketing Concept

The marketing concept, as described in the preceeding section cannot be considered as adequate if we look at the challenges posed by social problems like environmental pollution, deforestation, shortage of resources, population explosion and inflation. It is so because any activity which satisfies human needs but is detrimental to the interests of the society at large cannot be justified. The business orientation should, therefore, not be short-sighted to serve only consumers' needs. It should also consider large issues of long-term social welfare, as illustrated above.

The societal marketing concept holds that the task of any organisation is to identify the needs and wants of the target market and deliver the desired satisfaction in an effective and efficient manner so that the long-term well-being of the consumers and the society is taken care of. Thus, the societal marketing concept is the extension of the marketing concept as supplemented by the concern for the long-term welfare of the society. Apart from the customer satisfaction, it pays attention to the social, ethical and ecological aspects of marketing. There are large number of such issues that need to be attended.

Functions of Marketing

Marketing is concerned with exchange of goods and services from producers to consumers or users in such a way that maximises the satisfaction of customers' needs. From the view point of management function, number of activities are involved, which have been described as below:

1. Gathering and Analysing Market Information: One of the important functions of a marketer is to gather and analyse market information. This is necessary to identify the needs of the customers and take various decisions for the successful marketing of the products and services. This is important for making an analysis of the available opportunities and threats as well as strengths and weaknesses of the organisation and help in

The Future of Global Brands

Role of Digital connection and consumer cooperation

In China and India, booming middle classes and fast-rising disposable incomes have created a still-under-tapped consumer culture. Let's not forget the lessons being learned about the brand-building, power of digital connections and consumer co-creation. Since the advent of the internet, sites that offer social interaction and connectivity have been at the forefront of our digital revolution, reshaping the way consumers expect to interact with each other and, ultimately, with brands.

Online tag-sale site e-Bay, for example was one of the first sites to teach us that you can trust people online as well as you might trust a friendly neighbour. That social interaction paved the way for Friendster and MySpace and You Tube, a social networking tool that, in the past year, has empowered consumers to create their own content and post it to a global audience. Anyone who doubts the real market potential of such a platform only needs to check out October's biggest business headlines: Google purchased the site for $ 1.65 billion.

HSBC effort attempted a similar goal, to give consumers a forum for conversation. At your pointofview.com, consumers in 76 countries can weigh in and give their opinions on subjects including cloning, fashion, wind farms and video games.

Teenagers in Chinese cities surf the web for 5.1 hours a week, and the online ad-market is booming—by more than 75% annually for the past three years, according to *Business Week*, Mobile phones are among the most coveted pieces of technology. And 17.5 million bloggers (and their 75 million readers), many of whom fall within the coveted 18–25 age groups, are shaping consumer opinions in China with more intensity than they do in the US.

The internet age has put advertisers and branding experts face-to-face with an empowered consumer. And those consumers are happy to listen to our messages, as long as we are willing to listen to them.

Source: Adopted from Brand Equity, Nov. 1, 2006

deciding what opportunities can best be pursued by it. For example, rapid growth is predicted in several areas in the Indian economy, say in the use of the Internet, market for cell phones and several other areas. Which of these areas a particular organisation should enter, or in which area should it expand, requires a careful scanning of the strengths and weaknesses of the organisation, which is done with the help of careful market analysis.

With the growth of computers, a new trend has emerged in the collection of market information. More and more companies are using interactive sites on the internet, to gather customer views and opinions, before taking important business decisions. (see the box on Global Brands) One of the popular TV News Channel (in Hindi) seeks viewers choice (through SMS) on which of the given four or five main news stories of the day would be broadcasted as detailed story at the prime time, to ensure that the viewers get to listen to the story of their own choice.

2. Marketing Planning: Another important activity or area of work of a marketer is to develop appropriate marketing plans so that the marketing objectives of the organisation can be achieved. For example a marketer of colour TV, having 10 per cent of the current market share in the country, aims at enhancing his market share to 20 per cent, in the next three years. He will have to develop a complete marketing plan covering various important aspects including the plan for increasing the level of production, promotion of the products, etc. and specify the action programmes to achieve these objectives.

3. Product Designing and Development: Another important marketing activity or decision area relates to product designing and development. The design of the product contributes to making the product attractive to the target customers. A good design can improve performance of a product and also give it a competitive advantage in the market. For example, when we plan to buy any product say a motorbike, we not only see its features like cost, mileage, etc. but also the design aspects like its shape, style, etc.

4. Standardisation and Grading: Standardisation refers to producing goods of predetermined specifications, which helps in achieving uniformity and consistency in the output. Standardisation ensures the buyers that goods conform to the predetermined standards of quality, price and packaging and reduces the need for inspection, testing and evaluation of the products.

Grading is the process of classification of products into different groups, on the basis of some of its important characteristics such as quality, size, etc. Grading is particularly necessary for products which are not produced according to predetermined specifications, such as in the case of agricultural products, say wheat, oranges, etc. Grading ensures that goods belong to a particular quality and helps in realising higher prices for high quality output.

5. Packaging and Labelling: Packaging refers to designing and developing the package for the products. Labelling refers to designing and developing the label to be put on the package. The label may vary from a simple tag to complex graphics.

Packaging and labelling have become so important in modern day marketing that these are considered as the pillars of marketing. Packaging is important not only for protection of the products but also serves as a promotional tool. Sometimes, the quality of the product is assessed by the buyers form packaging. We have seen that in the success of many of the consumer brands in recent times such as *Lays* or *Uncle Chips* potato wafers *Clinic Plus* shampoos, and *Colgate Toothpaste*, etc., packaging has played an important role.

6. Branding: A very important decision area for marketing of most consumer products is whether to sell the product in its generic name (name of the category of the product, say Fan, Pen, etc.) or to sell them in a brand name (such as Pollar Fan or Rottomac Pen). Brand name helps in creating product differentiation, i.e., providing basis for distinguishing the product of a firm with that of the competitor, which in turn, helps in building customer's loyality and in promoting its sale. The important decision areas in respect of branding include deciding the branding strategy, say whether each product will be given a separate brand name or the same brand name will be extended to all products of the company, say Phillips bulbs, tubes and television or Videocon washing machine, television, and refrigerator. Selection of the brand name plays an important role in the success of a product.

7. Customer Support Services: A very important function of the marketing management relates to developing customer support services such as after sales services, handling customer complaints and adjustments, procuring credit services, maintenance services, technical services and consumer information. All these services aim at providing maximum satisfaction to the customers, which is the key to marketing success in modern days. Customer support services are very effective in bringing repeat sales from the customers and developing brand loyality for a product.

8. Pricing of Product: Price of product refers to the amount of money customers have to pay to obtain a product. Price is an important factor affecting the success or failure of a product in the market. The demand for a product or service is related to its price. Generally lower the price, higher would be the demand for the product and vice-versa. The marketers have to properly analyse the factors determining the price of a product and take several crucial decisions in this respect, including setting the pricing objectives, determining the pricing strategies, determining the price and changing the prices.

9. Promotion: Promotion of products and services involves informing the customers about the firm's product, its features, etc. and persuading them to purchase these products. The four important methods of promotion include advertising, Personal Selling, Publicity and Sales Promotion. A marketer has to take several crucial, decisions in respect of promotion of the products and services such as deciding the promotion budget, the promotion mix, i.e., the combination of the promotional tools that will be use, the promotion budget, etc.

10. Physical Distribution: Managing physical distribution is another very important function in the marketing of goods and services. The two major decision areas under this function include (a) decision regarding channels of distribution or the marketing intermediaries (like whole salers, retailers) to be used and (b) physical movement of the product from where it is produced to a place where it is required by the customers for their consumption or use. The important decision areas under physical distribution include managing inventory (levels of stock of goods), storage and warehousing and transportation of goods from one place to the other.

11. Transportation: Transportation involves physical movement of goods from one place to the other. As generally the users of products, particularly consumer products are wide spread and geographically separated from the place these are produced, it is necessary to move them to the place where it is needed for consumption or use, For example, tea produced in Assam has to be transported not only within the state but to other far off places like Tamil Nadu, Punjab, Jammu and Kashmir and Haryana, Rajasthan, where it is consumed.

A marketing firm has to analyse its transportation needs after taking into consideration various factors such as nature of the product, cost and location of target market and take decisions in respect of mode of transportation to be chosen and other related aspects.

12. Storage or Warehousing: Usually there is a time gap between the production or procurement of goods and their sale or use. It may be because of irregular demand for the products such as in the case of woollen garments or Raincoats or there may be irregular supply because of seasonal production such as in the case of agricultural products (sugarcane, rice, wheat, cotton, etc.). In order to maintain smooth flow of products in the market, there is a need for proper storage of the products. Further, there is a need for storage of adequate stock of goods to protect against unavoidable delays in delivery or to meet out contingencies in the demand. In the process of marketing, the function of storage is performed by different agencies such as manufacturers, wholesalers and retailers.

Role of Marketing

All marketing organisations operate either to earn profit or pursue some other goals such as community service, improvement of quality of life or promotion of a cause, say UNICEF working for the welfare of children or 'Helpage' working for the cause of senior citizens. Whether it is a profit organisation or a non-profit organisation, marketing plays an important role in achieving its objectives. It helps the individual consumers in raising their standard of living by making available the products and services that satisfy their needs and wants. It also plays a significant role in the economic development of a nation. The role of marketing in different situations may be described in brief as follows.

Role in a Firm

The modern concept of marketing plays a significant role in achieving the objectives of a firm. It emphasises that customer satisfaction is the key to the survival and growth of an organisation in the contemporary competitive marketing environment. By adopting marketing orientation, an organisation whether profit making or non-profit making, can achieve its goals in the most effective manner. It helps in focusing the activities of an organisation on the needs and wants of the customers. For example, what products or services will be marketed by a firm will depend upon what do its customers need. Thus, an analysis of the needs of the customers shall be undertaken in order to decide what to produce and sell. The product will then be designed according to the needs of the potential buyers and be made available through the outlets convenient to customers and be priced at a level which the target customers can afford. In other words, marketing as a business philosophy helps in serving the customers by satisfying their needs. It is a well known fact that a satisfied customer is the most valuable asset of any firm. Thus, marketing plays a crucial role in the survival and growth of a firm.

Role in the Economy

Marketing plays a significant role in the development of an economy. It acts as a catalyst in the economic development of a country and helps in raising the standards of living of the people.

Development of a nation can be judged by the level of standard of living of its people. Another important criteria, which is related to the first one, is the per capita income of an average citizen of a country. On this basis, an underdeveloped country may be stated to be one which is characterised by factors like poverty, scarcity of goods and services, predominance of agriculture, etc.

Marketing can play a significant role in the economic development of a nation. It can inspire people to undertake new activities and to set up enterprises for producing goods that are needed by the customers. Marketing can help in overcoming obstacles posed by high prices due to imbalances in the levels of production and consumption. It can also ensure smooth flow of goods through efficient physical distribution arrangements.

In other words, marketing can help in finding out right type of products and services that a firm should manufacture, the places where it should make such products available for sale, the price at which the products should be sold and the channels that should be used for moving the products to the ultimate place of consumption or use. This linkage between the business and consumption centres, accelerates the economic activity leading to higher incomes, more consumption and increased savings and investment.

Test your Understanding II

State whether the following statements are true or false:

(i) packaging serves as a promotional tool;

(ii) storage adds time value to the product;

(iii) financing is important for marketing only high value products;

(iv) marketing play important role from the point of view of individual consumers only; and

(v) marketing acts as a catalyst in the economic development of a country.

Marketing Mix

As stated in an earlier section, the process of marketing involves creating a market offering, to satisfy the needs and wants of the present and potential buyers. The real question is how to create a market offering. Let us say a profitable business opportunity is seen by some firm in the field of producing soft drinks. To develop and market a new brand of soft drinks, a number of important decisions will have to be taken for example whether to go for any collaboration with a foreign manufacturer of soft drinks, whether to produce for the local market or for a wider market, what will be the features of the new product, and so on.

There are large number of factors affecting marketing decisions. These can broadly be divided into two categories: (i) controllable factors, and (ii) non-controllable factors. Controllable factors are those factors which can be influenced at the level of the firm. In the previous illustration, for example, whether the drink will be packed in glass bottles or plastic cans; what will be the name (brand name) of the drink; at what price it will be sold, (at par with the price at which other competitive brands are sold or below it or above it); what distribution network will be used to make the product available (e.g., hotels, restaurants, groceries shops, kiosks selling cigarette, *paan*, etc.) to the buyers whether the new soft drink will be promoted by putting up advertisements in newspaper or magazine or on radio or television; or say if newspaper, whether in a local newspaper or a national daily; whether in a paper of regional language or an English daily, etc. is decided at the level of marketing manager of the firm.

However, there are certain other factors which affect the decision but are not controllable at the firm's level. These are called environmental variables. For example, the political factors such as the government policy on whether to allow any technical or financial collaboration in the area of soft drinks, production or economic factors such as rate of inflation prevailing in a given period or a credit policy of the central bank affecting the total availability of money in the market, all of which affect the sale of a particular product but can not be controlled or influenced by the decisions at the level of a firm. To be successful, the decisions regarding 'controllable factors' are to be taken keeping the environmental variables into consideration.

The controllable variables become marketing tools, which are constantly shaped and reshaped by marketing managers, to achieve marketing success. For example, a firm can reshape a market offering by bringing in a change in any of the variable under its own control, say introducing a change in the price or promotion offer or product features or channel used to make the product available to buyers. Thus, from a number of alternatives available a firm chooses a particular combination to develop a market offering. The combination of variables chosen by a firm to prepare its market offering is also called marketing mix. Thus, marketing mix is described as the set of marketing tools that a firm uses to pursue its marketing objectives in a target market.

Elements of Marketing Mix

The marketing mix consists of various elements, which have broadly been classified into four categories, popularly known as four Ps of marketing. These are: (i) Product, (ii) Price, (iii) Place, and (iv) Promotion. These are briefly discussed as follows:

1. Product: Product means goods or services or 'anything of value', which is offered to the market for sale. For example, Hindustan lever offers number of consumer products like toiletries (Close-Up toothpaste, Lifebuoy soap, etc.),

Marketing Mix: Elements

Product
Product Mix
Product Quality
New Product
Design and Development
Packaging
Labelling
Branding

Price
Price Level
Margins
Pricing Policy
Pricing Strategies
Price Change

Place
Channel Strategy
Channel Selection
Channel Conflict
Channel Cooperation
Physical Distribution

Promotion
Promotion Mix
Advertising
Personal Selling
Sales Promotion
Publicity
Public Relations

detergent powder (Surf, Wheel), food products (Refined Vegetable Oil); Tata offers Tata Steel, Trucks, Salt and a large number of other products; LG Electronics offers televisions, refrigerators, colour monitors for computers, etc; Amul offers a number of food products (Amul milk, ghee, butter, cheese, chocolates, etc.).

The concept of product relates to not only the physical product as mentioned in the above examples but also the benefits offered by it from customer's view point (for example toothpaste is bought for whitening teeth, strengthening gums, etc.). The concept of product also include the extended product or what is offered to the customers by way of after sales services, handling complaints, availability of spare parts etc. These aspects are very important, particularly in the marketing of consumer durable products (like Automobiles, Refrigerators, etc.). The important product decisions include deciding about the features, quality, packaging, labelling and branding of the products.

2. Price: Price is the amount of money customers have to pay to obtain the product. In case of most of the products, level of price affects the level of their demand. The marketers have not only to decide about the objectives of price setting but to analyse the factors determining the price and fix a price for the firm's products. Decisions have also to be taken in respect of discounts to customers, traders and credit terms, etc. so that customers perceive the price to be in line with the value of the product.

3. Place: Place or Physical Distribution include activities that make firm's products available to the target customers. Important decision areas in this respect include selection of dealers or intermediaries to reach the customers, providing support to the intermediaries (by way of discounts, promotional campaigns, etc.). The intermediaries in turn keep inventory of the firm's products, demonstrate them to potential buyers, negotiate price with buyers, close sales and also service the products after the sale. The other decision areas relate to managing inventory, storage and warehousing and transportation of goods from the place it is produced to the place it is required by the buyers.

4. Promotion: Promotion of products and services include activities that communicate availability, features, merits, etc. of the products to the target customers and persuade them to buy it. Most marketing organisations, undertake various promotional activities and spend substantial amount of money on the promotion of their goods through using number of tools such as advertising, personal selling and sales promotion techniques (like price discounts, free samples, etc.). A large number of decisions are to be taken in each of the area specified above. For example, in the respect of advertising it is important to decide about the message, the media to be used (example, print-media–newspaper, magazines, etc. the objections of customers, etc.).

The success of a market offer will depend on how well these ingredients are mixed to create superior value for the customers and simultaneously achieve their sale and profit objectives. Let us say a firm would like to achieve necessary volume of sale at a cost that will permit a desired level of profit. But so many alternative mixes can be adopted by a firm to achieve this objectives. The issue before a firm then is to decide what would be the most effective combination of elements to achieve the given objectives.

PRODUCT

In common parlance, the word 'product', is used to refer only to the physical or tangible attributes of a product. For example, we say we have bought a car or a pen or a Cell phone or a tractor.

Our decision to buy a product is not only affected by its physical qualities, but also by certain non-tangible and psychological factors, e.g., brand name, reputation, guaranty, packaging etc. Let us say, when a person buys a car, he/she is not just buying a few nuts and bolts, an engine, four wheels and so on. Rather he/she is buying a means of transport, a status symbol, guarantees and warranties accompanying the product, image of the company and many other such attributes. Thus, in marketing, product is a mixture of tangible and intangible attributes, which are capable of being exchanged for a value, with ability to satisfy customer needs. Besides physical objects, we also include services, ideas, persons, and places in the

PepsiCo Eyes New Products, Acquisitions

Aims at Adding Production Capacity for Gatorade and other Non-carbonated Drinks

PepsiCo on Monday said it will launch new healthier products next year and focus on growth in emerging markets, a continuation of the strategy that helped the world's No. 2 beverage company stay profitable ever as sales growth of its flagship soft drinks has slowed.

PepsiCo's new CEO Indra Nooyi, who took the reins on October 1, also said the company was on track to meet its annual target of volume and revenue growth in the mid-single digits and earnings per share growth in the low double digits.

PepsiCo evolved from being known mostly for selling soda and salty snacks into a $33-billion food company that has embraced the push into healthier options like Tropicana juice, Aquafina water and whole grain Quaker Oats Cereals.

The company said that moving forward, its capital expenditure as a percentage of sales would increase, and that most of the increased spending will go to expansion in developing and emerging markets and adding manufacturing capacity for Gatorade and other non-carbonated drinks.

Source: Adopted from Economic Times, Oct. 25, 2006

concept of product. Thus, product may be defined as anything that can be offered to a market to satisfy a want or need. It is offered for attention, acquisition, use or consumption.

From the customer's point of view, a product is a bundle of utilities, which is purchased because of its capability to provide satisfaction of certain need. A buyer buys a product or service for what it does for her or the benefit it provides to her. There can be three types of benefits a customer may seek to satisfy from the purchase of a product, viz., (i) functional benefits, (ii) psychological benefits, and (iii) social benefits. For example, the purchase of a motorcycle provides functional utility of transportation, but at the same time satisfies the need for prestige and esteem and provides social benefit by the way of acceptance from a group, by riding a motorbike. Thus, all these aspects should be considered while planning for a product.

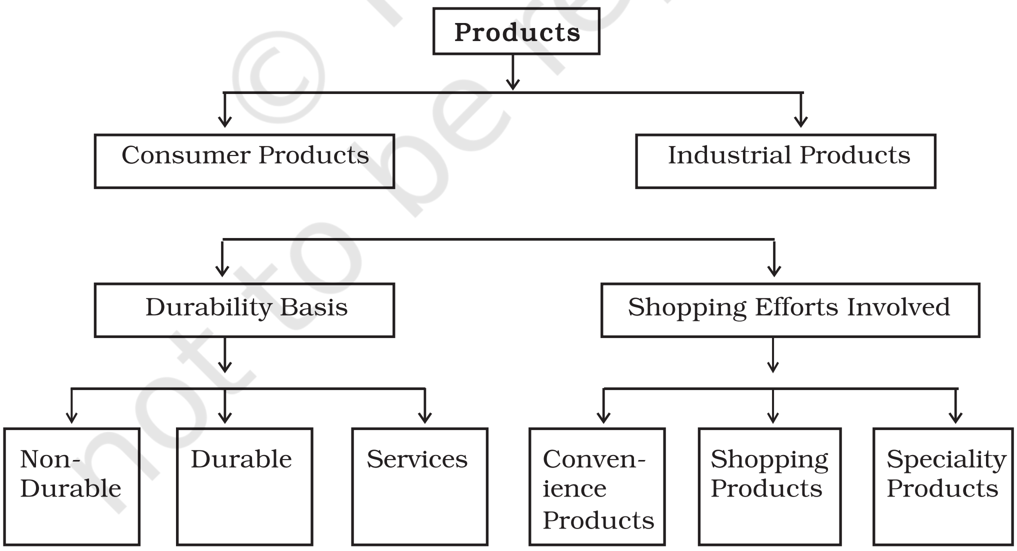
It is customer for companies to review the progress of their present products and constantly look for opportunities of diversifying into never areas. (see box on PepsiCo.)

Let Us Do It

Enlist the functional, psychological and social benefits that can be achieved by the purchase of (i) Personal computer, (ii) Colour television, (iii) Wrist watch.

Classification of Products

Products may broadly be classified into two categories — (i) consumers' products, and (ii) industrial products. The consumer products may further



Classification of Products

be classified into different groups, as detailed below:

Consumer Products

Products, which are purchased by the ultimate consumers or users for satisfying their personal needs and desires are referred to as consumer products. For example, soap, edible oil, eatables, textiles, toothpaste, fans, etc. which we use for our personal and non-business use are consumer goods.

The consumer products have been classified on the basis of two important factors: (A) the extent of shopping efforts involved, and (B) durability of the product. These have been explained as below:

A. Shopping Efforts Involved

On the basis of the time and effort buyers are willing to spend in the purchase of a product, we can classify the consumer product into the following three categories as here under:

1. Convenience Products: Those consumer products, which are purchased frequently, immediately and with least time and efforts are referred to as convenience goods. Examples of such products are cigarettes, ice creams, medicines, newspaper, stationery items toothpaste. etc. These products have low unit-value and are bought in small qualities. Some of the important characteristics of such products are:

Convenience Products

(a) These products are purchased at convenient locations, with least efforts and time;

(b) Convenience products have a regular and continuous demand, as these generally come under the category of essential products;

(c) These products have small unit of purchase and low prices. For example the eggs are sold at Rs. 28 per dozen and the customers purchase them in small numbers;

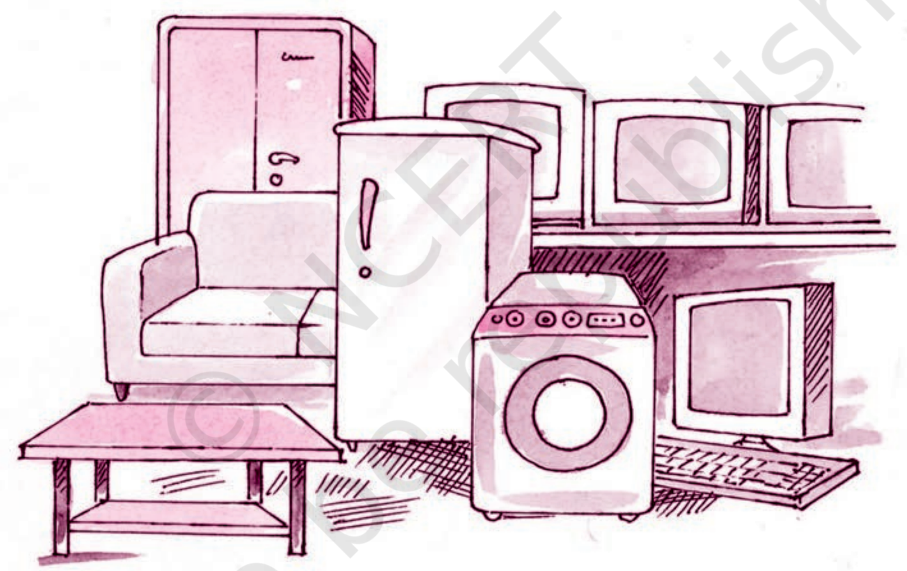
(d) Convenience products have standardised price as most of these products are branded products;

(e) The competition in these products is high as the supply is greater than the demand. The marketers have, therefore, to heavily advertise for these products; and

(f) Sales promotion schemes or short-term incentives such as sales contests, discount offers, etc play an important role in the marketing of such products.

2. Shopping Products: Shopping products are those consumer goods, in the purchase of which buyers devote considerable time, to compare the quality, price, style, suitability, etc., at several stores, before making final purchase. Some of the examples of shopping products are clothes, shoes, jewellery, furniture, radio, television, etc. The important characteristics of shopping products are as below:

(a) The shopping products are generally of durable nature, i.e., they normally survive many uses;



Shopping Products

(b) The unit price as well as profit margin of shopping products is generally high;

(c) As these products have high unit price, customers compare the products of different companies before making selection;

(d) Purchases of shopping products are generally pre-planned and there is little degree of impulse buying in these products; and

(e) Retailers generally play an important role in the sale of shopping products as lot of persuasive effort is needed to convince the buyers to purchase them.

3. Speciality Products: Speciality products are those consumer goods which have certain special features because of which people make special efforts in their purchase. These products are such, which have reached a brand loyalty of the highest order, with a significant number of buyers. The buyers are willing to spend a lot of time and efforts on the purchase of such products. For example, if there is a rare collection of artwork or of antiques, some people may be willing to spend a lot of shopping effort and travel long distance to buy such products. In our day-to-day life, we see people going to a particular hair-cutting saloon or restaurant, or a tailor. The demand for these goods is relatively inelastic, i.e., even if the price is increased, the demand does not come down. Some of the important characteristics of the speciality products may be summed up as follows:

(a) The demand for speciality products is limited as relatively small number of people buy these products;

(b) These products are generally costly and their unit price is very high;

Speciality Products

(c) These products are available for sale at few places as the number of customers is small and are willing to take extra efforts in the purchase of these products;

(d) An aggressive promotion is required for the sale of speciality products, in order to inform people about their availability, features, etc.; and

(e) After sales services are very important for many of the speciality products.

B. Durability of Products

On the basis of their durability, the consumer products have been classified into three categories— Durable, Non-durable and Services.

1. Non-durable Products: The consumer products which are normally consumed in one or few uses are called non-durable products. For example, we purchase products like toothpaste, detergents, bathing soap and stationary products etc. From the marketing point of view, these products generally command a small margin, should be made available in many locations and need to be heavily advertised.

2. Durable Products: Those tangible consumer products which normally survive many uses, for example, refrigerator, radio, bicycle, sewing machine and kitchen gadgets are referred to as durable products. These goods are generally used for a longer period, command a higher per unit margin, require greater personal-selling efforts, guarantees

Marketing of Services

India Post Has 28% Market Share Against Blue Dart's 20%

Speed Post Leads the Race in Express Mail

Speed Post has emerged as a market leader in the express mail category with a 27.55% volume share, a study commissioned by the Department of Post (DOP) and government of India shows.

According to the study, almost 46.67% crore articles were sent by express mail in 05-06. The study values the express mail industry alone (excluding logistics and cargo which account for almost 35-40% of private firm's turnover) at around Rs 1,500 crore. In value terms, while Speed Post is the leader, Blue Dart is a close second with a 20% market share, followed by DTDC with a 11.91% share and First Flight with a 10.89% share.

"This has been possible because of our competitive pricing. We are offering the same services as other private couriers do, with the same efficiency but at half the rates", added Mr. Samuel. In fact, Speed Post claims that its volumes have increased by almost 30-40% after the introduction of the One India One Rate scheme.

Express companies are hopeful that the market is going to grow further with the setting up of SEZs and greater economic activity in the country fuelled by the increasing throughput from the manufacturing sector.

Source: Adopted from Economic Times, Oct. 20, 2006

and after sales services, on the part of the seller.

3. Services: The durable and non-durable goods are tangible in the sense that these have a physical existence and can be seen and touched. Services are intangible in form. By services we mean those activities, benefits or satisfactions, which are offered for sale, e.g., dry cleaning, watch repairs, hair cutting, postal services, services offered by a doctor, an architect and a lawyer. Some of the distinguishing characteristics of services are as follows:

(a) By their very nature, services are intangible, i.e., we can not see, feel or touch them;

(b) A service is inseparable from its source. That means we cannot separate the service from the person providing the service;

(c) The services cannot be stored. They are highly perishable. For example, if a tailor does not work for one week, the services he would have provided during such period go waste; and

(d) Services are highly variable as their type and quality depends on the person providing them. That is why, there is a difference in the extent of satisfaction we get from the services provided by different people.

Industrial Products

Industrial products are those products, which are used as inputs in producing other products. The examples of such products are raw materials, engines, lubricants, machines, tools, etc. In other words, industrial products are meant for non-personal and business use for producing other products.

The market for industrial products consists of manufacturers, transport agencies, banks and insurance companies, mining companies and public utilities. The important characteristics of industrial products are given below:

1. Number of Buyers: As compared to the consumer products, the numbers of buyers of industrial products are limited. For example, sugarcane is purchased by few producers of sugar, but sugar, which is a consumer product, is purchased by crores of people in our country.

2. Channel Levels: Because of limited number of buyers, the sale of industrial products is generally made with the help of shorter channels of distribution, i.e., direct selling or one level channel.

3. Geographic Concentration: Because of location of industries at certain points or regions, industrial markets are highly concentrated, geographically. For instance, the demand for power loom comes from Bombay, Sholapur, Bangalore, etc. where the textile industry is concentrated in our country.

4. Derived Demand: The demand for industrial products is derived from the demand for consumer products. For example, the demand for leather will be derived from demand for shoes and other leather products in the market.

5. Role of Technical Considerations: Technical considerations assume greater significance in the purchase of industrial products because these products are complex products, bought for use in business operations.

6. Reciprocal Buying: Some big companies from basic industries like oil, steel, rubber, and medicines resort to the practice of reciprocal buying. For example, Ashok Leyland may buy tyres and tubes from MRF, which in turn may buy trucks from Leyland, whenever it feels the need for the same.

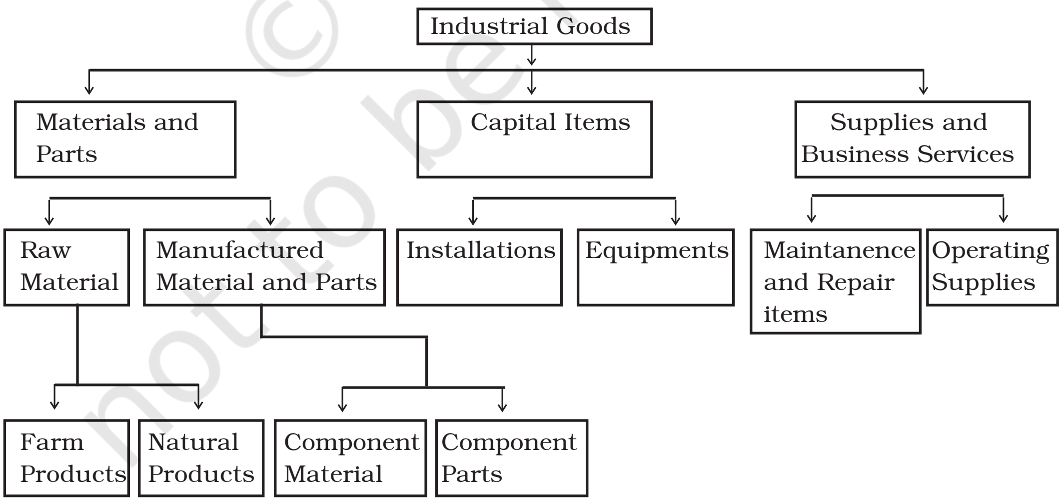
7. Leasing Out: A growing trend in industrial product market is to lease out rather than to purchase the products on outright basis because of the heavy price of these products.

Classification

The industrial goods are classified into the following major categories:

(i) *Materials and Parts:* These include goods that enter the manufacture's products completely. Such goods are of two types: (a) Raw material: including farm products like cotton, sugar cane, oil seed and natural products such as minerals (say crude petroleum, iron ore), fish and lumber; and (b) manufactured material and parts. These are again of two types – component materials like glass, iron, plastic and component parts such as tyre, electric bulb, steering, and battery.

(ii) *Capital Items:* These are such goods that are used in the



Classification of Industrial Goods

production of finished goods. These include: (a) installations like elevators, mainframe Computers, and (b) equipments like Hand Tools, Personal Computer, Fax Machines, etc.

Test Your Understanding III

Please check whether the following statements are true or false:

(i) Products purchased by ultimate consumers for satisfying their personal needs are referred to as industrial products.
(ii) Speciality products are generally costly and their unit price is high.
(iii) Purchase of convenience products in generally pre-planned.
(iv) Shopping products are purchased frequently, immediately and with least efforts.
(v) Sales promotional schemes play important role in the sale of industrial products.
(vi) Product is anything that can be offered to a market to satisfy a want or need.
(vii) Durable products are normally consumed in one or few uses.
(viii) Services can not be stored.
(ix) Furniture is an example of consumer non-durable product.
(x) Toothpaste is an example of consumer product.

(iii) *Supplies and Business Services:* These are short lasting goods and services that facilitate developing or managing the finished product. These include: (a) maintenance and repair items like Paint, Nails, etc., and (b) operating supplies like Lubricant, Computer Stationary, Writing Paper, etc.

The difference in the nature of consumer products and industrial products is important because of the fact that the buyers of the two sets of products have different buying motives and have different attitudes and use different approaches in the purchase of the products. For example, an industrial buyer is expected to be more rational who will study the cost of different available brands, their technical specifications and the goodwill of the supplier. Whereas, the buyer of a consumer product may be more impulsive and emotional who is susceptible to advertising and various sales promotion schemes.

BRANDING

One of the most important decisions that a marketer has to take in the area of 'product' is in respect of branding. He has to decide whether the firm's products will be marketed under a brand name or a generic name.

Generic name refers to the name of the whole class of the product. For example, a book, a wristwatch, tyre, camera, toilet soap, etc. We know that a camera is a lens surrounded by plastic or steel from all sides and having certain other features such as a flash gun and so on. Similarly book is a bunch of papers, which are in a bound form, on which some useful information about a subject is printed. Thus, all products having these characteristics would be called by the generic name such as camera or book.

If products were sold by generic names, it would be very difficult for the marketers to distinguish their products from that of their competitors. Thus, most marketers give a name to their product, which helps in identifying and distinguishing their products from the competitors' products. This process of giving a name or a sign or a symbol etc., to a product is called branding. The various terms relating to branding are as follows:

1. **Brand:** A brand is a name, term, sign, symbol, design or some combination of them, used to identify the products—goods or services of one seller or group of sellers and to differentiate them from those of the competitors. For example, some of the common brands are Bata, Lifebuoy, Dunlop, Hot Shot, and Parker. Brand is a comprehensive term, which has

Brands and Branding

Branding is creating a corporate brand identity for consumer, and getting that brand identity imprinted on the minds of consumer, and this requires brand positioning and brand management.

A brand today is an entity (product. service, company, person, technology, etc.), that offers a set of value exchange measures between what the owner/ market seeks and the price he is willing to pay for.

It has always seemed to me that your brand is formed primarily, not by what your company says about itself, but what the company does.

— Jeff Bezos

A product is something made in a factory; a brand is something that is bought by the customer. A product can be copied by a competitor; a brand is unique. A product can be quickly outdated; a successful brand is timeless.

— Stephen King

Your brand's power lies in dominance. It is better to have 50% of one market, instead of 10% of five markets.

— Al Ries

Your brand image is primarily an emotional construct. Emotion is probably always more powerful in swaying people than reason. but people like to be able to rationalise their choices.

— Drayton Bird

Source: Adopted from Effective Executive, 2006

two components—brand name and brand mark. For example, Asian Paints has the symbol of Gattu on its pack, which is its brand mark.

2. Brand Name: That part of a brand, which can be spoken, is called a brand name. In other words, brand name is the verbal component of a brand. For example, Asian Paints, Safola, Maggie, Lifebuoy, Dunlop, and Uncle Chips are the brand names.

3. Brand Mark: That part of a brand which can be recognised but which is not utter able is called brand mark. It appears in the form of a symbol, design, distinct colour scheme or lettering. For example, the Gattu of Asian Paints or Devil of Onida or symbol of Yogkshma of LIC, or four fingers and a palm of Anacin are all brand marks.

4. Trade Mark: A brand or part of a brand that is given legal protection is called trademark. The protection is given against its use by other firms. Thus the firm, which got its brand registered, gets the exclusive right for its use. In that case, no other firm can use such name or mark in the country.

Though branding adds to the cost e.g., to the cost of packaging, labelling, legal protection, and promotion, it provides several advantages to the sellers as well as the consumers.

Advantages to the Marketers

(i) *Enables Marking Product Differentiation:* Branding helps a firm in distinguishing its product from that of its competitors. This enables the firm to secure and control the market for its products.

(ii) *Helps in Advertising and Display Programmes:* A brand aids a firm in its advertising and display programmes. Without a brand name, the advertiser can only create awareness for the generic product and can never be sure of the sale for his product.

(iii) *Differential Pricing:* Branding enables a firm to charge different price for its products than that charged by its competitors. This is possible because if customers like a brand and become habitual of it, they do not mind paying a little higher for it.

(iv) *Ease in Introduction of New Product:* If a new product is introduced under a known brand, it enjoys the reflected glory of the brand and is likely to get off to an excellent start. Thus, many companies with established brand names decide to introduce new products in the same name. For example, Food Specialties Ltd. had a successful brand Maggie (Noodles), it extended this name to many of its new products introduced such as Tomato Ketchup, Soups, etc. Similarly Samsung extended the brand name of its Television to Washing Machines and other durable products, like Microwave oven.

Advantages to Customers

(i) *Helps in Product Identification:* Branding helps the customers in identifying the products. For example, if a person is satisfied with a particular brand of a product, say tea leaves or detergent soap, he need not make a close inspection every time, he has to buy that product. Thus, branding greatly facilitates repeat purchase of the products.

(ii) *Ensures Quality:* Branding ensures a particular level of quality of the product. Thus, whenever there is any deviation in the quality, the customers can have recourse to the manufacturer or the marketer. This builds up confidence of the customers and helps in increasing his level of satisfaction.

(iii) *Status Symbol:* Some brands become status symbols because of their quality. The consumers of those brands of products feel proud of using them and adds to the level of satisfaction of the customers.

Characteristics of Good Brand Name

Choosing the right brand name is not an easy decision. What makes this decision important is the fact that once a brand name is chosen and the product is launched in the market, changing the brand name is very difficult. So, getting it right the first time is very essential. Following are some of the considerations, which should be kept in mind while choosing a brand name.

(i) The brand name should be short, easy to pronounce, spell, recognise and remember e.g., Ponds, VIP, Rin, Vim, etc.

(ii) A brand should suggest the product's benefits and qualities. It should be appropriate to the product's function. e.g., Rasika, Genteel, Promise, My Fair Lady and Boost.

(iii) A brand name should be distinctive e.g., Liril, Sprit, Safari, Zodiac.

(iv) The brand name should be adaptable to packing or labelling requirements, to different advertising media and to different languages.

(v) The brand name should be sufficiently versatile to accommodate new products, which are added to the product line e.g., Maggie, Colgate.

(vi) It should be capable of being registered and protected legally.

Do it Yourself

Visit a retail store in your locality and prepare a list of the (i) number of brands available, (ii) the price of each brand, and (iii) most selling brand in respect of any three consumer non-durable products such as Toilet Soap, Detergent Powder, Cooking, Oil, Toothpaste, Tea, etc. used in your family. Which brand of each of the product selected is used in your family? Give reasons.

(vii) Chosen name should have staying power i.e., it should not get out of date.

Packaging

One of the most important developments affecting the business world in recent years has been in the area of packaging. Many products, which we thought could never lend themselves to packing because of their nature, have been successfully packed e.g., Pulses, Ghee, Milk, Salt, Cold Drinks, etc. Packaging refers to the act of designing and producing the container or wrapper of a product. Packaging plays a very important role in the marketing success or failure of many products, particularly the consumer non-durable products. In fact if one makes an analysis of the reasons for the success of some of the successful products in the recent past, it can be noted that packaging has played its due role. For example, it was one of the important factors in the success of products like Maggie's Noodles, Uncle Chips or Crax wafers.

Levels of Packaging

There can be three different levels of packaging. These are as below:

1. Primary Package: It refers to the product's immediate container. In some cases, the primary package is kept till the consumer is ready to use the product (e.g., plastic packet for socks); whereas in other cases, it is

Levels of Packaging

kept throughout the entire life of the product (e.g., a toothpaste tube, a match box, etc.).

2. Secondary Packaging: It refers to additional layers of protection that are kept till the product is ready for use, e.g., a tube of shaving cream usually comes in a card board box. When consumers start using the shaving cream, they will dispose off the box but retain the primary tube.

3. Transportation Packaging: It refers to further packaging components necessary for storage, identification or transportation. For example a toothpaste manufacturer may send the goods to retailers in corrugated boxes containing 10, 20, or 100 units.

Importance of Packaging

Packaging has acquired great significance in the marketing of goods and services, because of following reasons:

(i) *Rising Standards of Health and Sanitation:* Because of the increasing standards of living in the country, more and more people have started purchasing packed goods as the chances of adulteration in such goods are minimised.

(ii) *Self Service Outlets:* The self-service retail outlets are becoming very popular, particularly in major cities and towns. Because of this, some of the traditional role assigned to personal selling in respect of promotion has gone to packaging.

(iii) *Innovational Opportunity:* Some of the recent developments in the area of packaging have completely changed the marketing scene in the country. For example, milk can now be stored for 4-5 days without refrigeration in the recently developed packing materials. Similarly, in the area of pharmaceuticals, soft drinks, etc., lots of new innovations have come in respect of packaging. As a result, the scope for the marketing of such products has increased.

(iv) *Product Differentiation:* Packaging is one of the very important means of creating product differentiation. The colour, size, material etc., of package makes real difference in the perception of customers about the quality of the product. For example, by looking at the package of a product say Paint or Hair Oil, one can make some guess about quality of the product contained in it.

Functions of Packaging

As stated above, packaging performs a number of functions in the marketing of goods. Some of the important functions are as follows:

(i) *Product Identification:* Packaging greatly helps in identification of the products. For example, Colgate in red colour, or Ponds cream jar can be easily identified by its package.

(ii) *Product Protection:* Packaging protects the contents of a product

from spoilage, breakage, leakage, pilferage, damage, climatic effect, etc. This kind of protection is required during storing, distribution and transportation of the product.

(iii) *Facilitating Use of the Product:* The size and shape of the package should be such that it should be convenient to open, handle and use for the consumers. Cosmetics, medicines and tubes of toothpastes are good examples of this.

(iv) *Product Promotion:* Packaging is also used for promotion purposes. A startling colour scheme, photograph or typeface may be used to attract attention of the people at the point of purchase. Sometimes it may work even better than advertising. In self-service stores, this role of packaging becomes all the more important.

Labelling

A simple looking but important task in the marketing of goods relates to designing the label to be put on the package. The label may vary from a simple tag attached to the product (such as in case of local unbranded products like sugar, wheat, pulses, etc.) indicating some information about the quality or price, to complex graphics that are part of the package, like the ones on branded products (say the graphic of Boat and Patwar on the package of a popular brand of After Shave Lotion or of a lady offering a pen to solicit the views of the users, on the label of a detergent powder). Lables are useful in providing detailed information about the product, its contents, method of use, etc. The various functions performed by a label are as follows:

1. Describe the Product and Specify its Contents: Let us look at some of the labels of the products used by us in our day to day life. The label on the package of a local tea company describes the company as ' Mohini Tea Company, an ISO 9001:200C Certified Company'; a popular brand of Prickly Heat Powder, describes how the product provides relief from prickly heat and controls bacterial growth and infection, giving caution forbidding its application on cuts and wounds. Package of fast food products like ready to eat Dosa, Idli or Noodles, describe the procedure of cooking these products; the Package of a toothpaste brand lists the 'Ten Teeth and Gum Problems', which the product claims to fight with its

Do it Yourself

Visit a local Grocery Shop and find out any two products which are sold both in packaged form and in loose (unpackaged) form and find out i) The product for which the sale in packaged form is greater ii) The product for which sale in loose form is greater. iii) the benefit, to the retailer in selling goods on i) packaged form and ii) unpackaged form.

'Complete Germicheck Formula'; the Package of a brand of Coconut Oil describes the product as pure coconut oil with Heena, Amla, Lemon and specifies how these are good for Hair. Thus, one of the most important functions of labels is to describe the product, its usage, cautions in use, etc. and specify its contents.

2. Identification of the Product or Brand: The other important function performed by labels is to help in identifying the product or brand. For example, the brand name of any product, say Biscuits or Potato Chips imprinted on its package helps us to identify, from number of packages, which one is our favourite brand. Other common identification information provided by the labels include name and address of the manufacturer, net weight when packed, manufacturing date, maximum retail price and Batch number.

3. Grading of Products: Another important function performed by labels is to help grading the products into different categories. Sometimes marketers assign different grades to indicate different features or quality of the product. For example, a popular brand of Hair Conditioners comes in different categories for different hair, say for 'normal hair' and for other categories. Different type of tea is sold by some brands under Yellow, Red and Green Label categories.

4. Helps in Promotion of Products: An important function of label is to aid in promotion of the products. A carefully designed label can attract attention and give reason to purchase. We see many product labels providing promotional messages for example, the pack of a popular Amla Hair Oil states, 'Baalon mein Dum, Life mein Fun'. The label on the package of a brand of Detergent Powder says, 'Keep cloth look good and your machine in top condition'. Labels play important role in sales promotional schemes launched by companies. For example the label on the package of a Shaving Cream mentions, '40% Extra Free' or package of a toothpaste mentioning, 'Free Toothbrush Inside', or 'Save Rs15'.

5. Providing Information Required by Law: Another important function of labeling is to provide information required by law. For example, the statutory warning on the package of Cigarette or Pan Masala, 'Smoking is Injurious to Health' or 'Chewing

Do it Yourself

1. Examine the label on the package of any three branded products recently purchased for use in your family and list out the type of information contained on these.
2. Find out the promotional messages given on the package of any three consumer products of your choice and comment how can these help in the sale of these products.

Tobacco is Injurious to Health'. Such information is required on processed foods, drugs and tobacco products. In case of hazardous or poisonous material, appropriate safety-warning need to be put on the label.

Thus, labels perform number of important functions relating to communicating with the potential buyers and promoting the sale of the products.

Pricing

When a product is bought, some money is paid for it. This money represent the sum of values that consumers exchange for the benefit of having or using the prdocut and is referred to as the price of the product. Similarly, money paid for the services such as fare for the transport service, premium for an insurance policy, and fee to a doctor for his medical advise represent the price of these services. Price may therefore be defined as the amount of money paid by a buyer (or received by a seller) in consideration of the purchase of a product or a service.

Pricing occupies an important place in the marketing of goods and services by a firm. No product can be launched without a price tag or at least some guidelines for pricing. Pricing is often used as a regulator of the demand of a product. Generally, if the price of a product is increased, its demand comes down, and vice-versa.

Pricing is considered to be an effective competitive weapon. In the conditions of perfect competition, most of the firms compete with each other on the basis of this factor. It is also the single most important factor affecting the revenue and profits of a firm. Thus, most marketing firms give high importance to the fixation of price for their products and services.

Factors Affecting Price Determination

There are number of factors which affect the fixation of the price of a product. Some of the important factors in this regard are discussed as below:

1. Product Cost: One of the most important factor affecting price of a product or service is its cost. This includes the cost of producing, distributing and selling the product. The cost sets the minimum level or the floor price at which the product may be sold. Generally all marketing firms strive to cover all their costs, at least in the long run. In addition, they aim at earning a margin of profit over and above the costs. In certain circumstance, for example, at the time of introducing a new product or while entering a new market, the products may be sold at a price, which does not cover all the costs. But in the long run, a firm cannot survive unless at least all its costs are covered.

There are broadly three types of costs: viz., Fixed Costs, Variable Costs and Semi Variable Costs. Fixed costs are those costs, which do not vary with the level of activity of a firm say with the volume of production or sale. For example, rent of a building or salary of a sales manager remains the same whether 1000 units or 10 units are produced in a week.

Those costs which vary in direct proportion with the level of activity are called variable costs. For example, the costs of raw material, labour and power are directly related with the quantity of goods produced. Let us say, if the cost of wood for manufacturing one chair comes to Rs.100 the cost of wood for 10 chairs would be Rs. 1000. Obviously, there will be no cost of wood if no chair is produced.

Semi variable costs are those costs which vary with the level of activity but not in direct proportion with it. For example, compensation of a sales person may include a fixed salary of say Rs. 10,000 plus a commission of 5 per cent on sales. With an increase in the volume of sales, the total compensation will increase but not in direct proportion with the change in the volume of sale.

Total Costs are the sum total of the fixed, variable and semi-variable costs for the specific level of activity, say volume of sales or quantity produced.

2. The Utility and Demand: While the product costs set the lower limits of the price, the utility provided by the product and the intensity of demand of the buyer sets the upper limit of price, which a buyer would be prepared to pay. In fact the price must reflect the interest of both the parties to the transaction—the buyer and the seller. The buyer may be ready to pay up to the point where the utility from the product is at least equal to the sacrifice made in terms of the price paid. The seller would, however, try to at least cover the costs. According to the law of demand, consumers usually purchase more units at a low price than at a high price.

The price of a product is affected by the elasticity of demand of the product. The demand is said to be elastic if a relatively small change in price results in large change in the quantity demanded. Here numerically, the price elasticity is greater than one. In the case of inelastic demand, the total revenue increases when the price is increased and goes down when the price is reduced. If the demand of a product is inelastic, the firm is in a better position to fix higher prices.

3. Extent of Competition in the Market: Between the lower limit and the upper limit where would the price settle down? This is affected by the nature and the degree of competition. The price will tend to reach the upper limit in case there is lesser degree of competition while under conditions of free competition, the price will tend to be set at the lowest level.

Competitors' prices and their anticipated reactions must be considered before fixing the price of a product. Not only the price but the quality and the features of the competitive products must be examined carefully, before fixing the price.

4. Government and Legal Regulations: In order to protect the interest of public against unfair practices in the field of price fixing, Government can intervene and regulate the price of commodities. Government can declare a product as essential product and regulate its price. For example, the cost of a drug manufactured by a company having monopoly in the production of the same come to Rs 20 per strip of ten and the buyer is prepared to pay any amount for it, say Rs 200. In the absence of any competitor, the seller may be tempted to extort the maximum amount of Rs 200 for the drug and intervene to regulate the price. Usually in such a case, the Government does not allow the firms to charge such a high price and intervene to regulate the price of the drug. This can be done by the Government by declaring the drug as essential commodity and regulating its price. (see box)

5. Pricing Objectives: Pricing objectives are another important factor affecting the fixation of the price of a product or a service. Generally the objective is stated to be maximise the profits. But there is a difference in maximising profit in the short run and in the long run. If the firm decides to maximise profits in the short run, it would tend to charge maximum price for its products. But if it is to maximise its total profit in the long run, it would opt for a lower per unit price so that it can capture larger share of the market and earn greater profits through increased sales.

Apart from profit maximisation, the pricing objectives of a firm may include:

(a) Obtaining Market Share Leadership: If a firms objective is to obtain larger share of the market; it will keep the price of its products at lower levels so that greater number of people are attracted to purchase the products;

(b) Surviving in a Competitive Market: If a firm is facing difficulties in surviving in the market because of intense competition or introduction of a more efficient substitute by a competitor, it may resort to

NPPA Sets 20% annual Cap for drug Price Rise

Drug price watchdog National Pharmaceutical Pricing Authority (NPPA) has decided to invoke the 'public interest' clause in the drugs law more often to pressure companies to reduce prices of medicines that go up more than 20% in a year.

The pricing body has also decided to limit its communication with companies to just one reminder asking them to respond to the show-cause notice on why the drug should not be recommended for price control, sources told ET.

NPPA has now started scrutinising the fluctuations in the price-to-retailer of 48,600 formulation packs every month. Every month, two to three formulations are likely to get caught on an average.

So far, NPPA has recommended 45 cases of alleged abnormal price increase to the Chemicals Ministry for appropriate action, on which the ministry has sent notices to 11 companies asking them to reduce prices or face price control.

Source: Adopted from The Economic Times, Nov. 3, 2006

discounting its products or running a promotion campaign to liquidate its stock; and

(c) Attaining Product Quality Leadership: In this case, normally higher prices are charged to cover high quality and high cost of Research and Development.

Thus, the price of a firm's products and services is affected by the pricing objective of the firm.

6. Marketing Methods Used: Price fixation process is also affected by other elements of marketing such as distribution system, quality of salesmen employed, quality and amount of advertising, sales promotion efforts, the type of packaging, product differentiation, credit facility and customer services provided. For example, if a company provides free home delivery, it has some of flexibility in fixing prices. Similarly, uniqueness of any of the elements mentioned above gives the company a competitive freedom in fixing prices of its products.

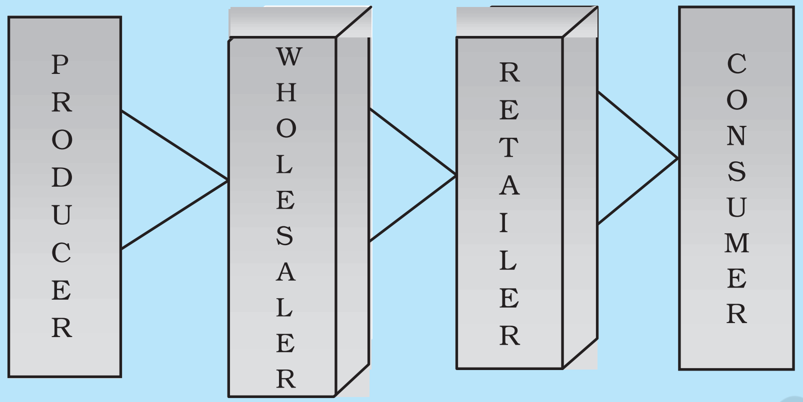
PHYSICAL DISTRIBUTION

The fourth important element of marketing mix is the physical distribution of products and services. It is concerned with making the goods and services available at the right place, so that people can purchase the same. There are two important decisions relating to this aspect—one regarding physical movement of goods from producers to consumers or users and two, regarding the channels or using intermediaries in the distribution process. These are described as follows:

Channels of Distribution

In case of large number of consumer products, the potential buyers are scattered over a wide geographical area. In order to contact these people efficiently and effectively, it is important to take the help of number of intermediaries as contacting them directly may not be cost effective and may be difficult even otherwise. For example, a manufacturer of detergent powder in Gujarat would find it very difficult to directly approach customers, say in Delhi, Thiruvananthapuram, Bhuvaneshwar, Hyderabad Srinagar and other far off places. Therefore, he/she would supply a large quantity of his/her product to a big merchant, say in Hyderabad. This big merchant would then supply detergent powder to relatively small sellers in various towns of Hyderabad. These sellers would, in turn, resell the goods to customers. In this manner, goods are distributed from the place of production to the place of consumption. These people, institutions, merchants, and functionaries, who take part in the distribution function, are called 'Channels of Distribution'. (see figure on channels)

Channels of Distribution are set of firms and individuals that take title, or assist in transferring title, to particular goods or services as it moves from the producers to the consumers. In other words, channel refers to a team of merchants, agents,



Channels of Distribution used for a Consumer Product

and business institutions that combine physical movement and title movement of products to reach specific destinations.

Mostly goods and services are distributed through a network of marketing channels. For example we buy merchandise of our need such as salt, bulb, tea, sugar, soap, paper, books, flour, etc., from retail sellers.

The channels bring economy of effort. This can be better understood with the help of an example. Let us say you have to buy four things, viz., Sugar, Bulb, Coffee and Ink. Most probably you would walk into a General Merchant's Shop and buy all the articles form one place. Imagine what would happen if there were no middlemen or general merchants available. In that case you would have to buy directly from the manufacturers of these products. You will have to make four contacts, each with the producer of Sugar, Bulb, Coffee and Ink. Compared to this, there was only one contact when all the things were bought from the same general merchant. Now let us assume that there are four customers needing the same four articles. In all sixteen contacts would have to be made. In case middleman are used, as shown in the part II of the figure, only eight contacts could be needed. Thus, use of middlemen brings economy of effort. This situation is illustrated in the preceeding figure.

Apart from the economy of effort, middlemen help to cover large geographical area and bring efficiency in distribution, including transportation, storage and negotiation. They bring convenience to customers as they make various items available at one store and also serve as authentic source of market information as they are in direct contact with the customer.

Functions of Distribution Channels

Channels of distribution smoothen the flow of goods by creating possession, place and time utilities. They facilitate movement of goods by overcoming various time, place and possession barriers that exist between the manufacturers and consumers. The important functions performed by middlemen are as follows:

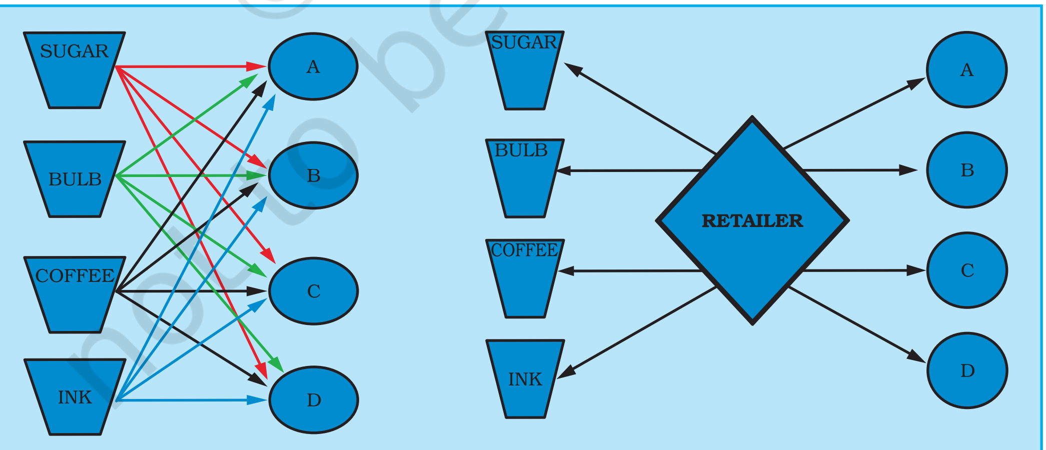
1. Sorting: Middlemen procure supplies of goods from a variety of sources, which is often not of the same quality, nature, and size. For example, a wholesaler of cashew nuts may procure a large quantity from different cashew nut producing areas, which would contain nuts of varied quality and sizes. He/She then sorts the nuts into homogenous groups on the basis of the size or quality.

2. Accumulation: This function involves accumulation of goods into larger homogeneous stocks, which help in maintaining continuous flow of supply.

3. Allocation: Allocation involves breaking homogenous stock into smaller, marketable lots. For example, once cashew nuts are graded and large quantities are built, these are divided into convenient packs of say 1 kg, 500 gms and 250 gms, to sell them to different types of buyers.

4. Assorting: Middlemen build assortment of products for resale. There is usually a difference between the product lines made by manufacturers and the assortment or combinations desired by the users. For example, a cricket player may need a bat, a ball, wickets, gloves, helmet, a T-shirt, and a pair of shoes. Perhaps no one manufacturer produces these products in desired combination. Middlemen procure variety of goods from different sources and deliver them in combinations desired by customers.

5. Product Promotion: Mostly advertising and other sales promotion activities are organised by manufacturers. Middlemen also participate in certain activities such as demonstrations, special displays,



Economy of Efforts with the use of Channels

contests, etc., to increase the sale of products.

6. Negotiation: Channels operate with manufacturers on the one hand and customers one, the other. Arriving at deals that satisfy both the parties is another important function of the middlemen. They negotiate the price, quality, guarantee and other related matters with customers so that transfer of ownership is properly affected.

7. Risk Taking: In the process of distribution of goods the merchant middlemen take title of the goods and thereby assume risks on account of price and demand fluctuations, spoilage, destruction, etc.

Types of Channels

A manufacturer may choose from direct distribution to indirect distribution and from a short channel consisting of few intermediaries to a long channel of distribution consisting of large number of middlemen. Each form of channel network differs in number and type of middlemen involved. The major types of channels are as follows:

Direct Channel (Zero Level)

The most simple and the shortest mode of distribution is direct distribution, where in the goods are made directly available by the manufacturers to customers, without

(i) Direct Channel (zero level)

Manufacturer → Customer

Indirect Channel

(ii) One level Channel

Manufacturer → Retailer → Customer

(iii) Two level Channel

Manufacturer → Wholesaler → Retailer → Customer

(iv) Three level Channel

Manufacturer → Agent → Wholesaler → Retailer → Customer

Types of Channels

involving any intermediary. This is also called zero level channel. A straight and direct relationship is established between the manufacturer and the customer. For example, when a manufacturer sells his goods through his own retail outlets (e.g., Mc Donald, Bata); it is referred to as direct channel. Similarly, mail order selling, internet selling and selling through own sales force, (e.g., Eureka Forbes) are example of direct selling or zero level channel.

Indirect Channels

When a manufacturer employs one or more intermediary to move goods from the point of production to the point of consumption, the distribution network is called indirect. This may take any of the following forms:

1. Manufacturer-Retailer Consumer (One Level Channel): In this form of arrangement one intermediary i.e., retailers is used between the manufacturers and the customers. That is, goods pass from the manufacture to the retailers who, in turn, sell them to the final users. For example, Maruti Udyog sells its cars and vans through company approved retailers. This type of distribution network enables the manufacturers to cover wide area of market while retaining control over the Channels.

2. Manufacturer-Wholesaler-Retailer-Consumer (Two Level Channel): This is the most commonly adopted distribution network for most consumer goods like soaps, oils, clothes, rice, sugar and pulses. Here the wholesaler and retailer function as connecting links between the manufacturer and consumer. Use of two middlemen in the channel network enables the manufacturer to cover a larger market area.

3. Manufacturer-Agent-Wholesaler-Retailer-Consumer (Three Level Channel): In this case, manufactures use their own selling agents or brokers who connect them with wholesalers and then the retailers. Thus, one more level is added to the levels discussed in the proceeding arrangement. It is done particularly when the manufacturer carries a limited product line and has to cover a wide market. An agent in each major area is appointed, who in turn contact the wholesalers.

Factors Determining Choice of Channels

Choice of appropriate channel of distribution is a very important marketing decision, which affects the performance of an organisation. Whether an organisation will adopt direct marketing channels or long channels involving number of intermediaries is a strategic decision. The choice of channels depends on various factors, which are discussed as follows:

1. Product Related Factors: The important product related considerations in deciding the channels include whether the product is an industrial or a consumer product, whether it is a perishable or a non-perishable product, what is the unit value of the product and the degree of complexity of the product.

Industrial products are usually technical, made to order and expensive products purchased by few buyers. These products require short channels i.e., direct channel or involving few middlemen.

Consumer products, on the other hand, are usually standardised, less expensive, less bulky, non-technical and frequently bought products. These can be better distributed by long network of channels, involving many middlemen. Perishable products like fruits, vegetables, and dairy products are best sold through short channels, while non-perishable products like toiletry products (e.g., soap, toothpaste, hair oil etc.), groceries (vegetable oil, tea leaf etc.), fabrics require longer channels to reach wide spread consumers.

If the unit value of a product is low as in case of most convenience products, long channels are preferred while in case of high value products, shorter channels may be used. Similarly, in case of complex products requiring technical details as in case of most industrial or engineering products, short channels are preferred but if the product is a non-complex one, it is sold through long channels, involving number of intermediaries.

2. Company Characteristics: The important company characteristics affecting the choice of channels of distribution include the financial strength of the company and the degree of control it wants to hold on other channel members. Direct selling involves lot of funds to be invested in

India to have Variants of $ Store

It's the cheap and cheerful concept that has worked all over the world. Now, its coming to your friendly neighbourhood mall but retail marketers are offering it with a weak or two.

Though the concept, relatively new to the Indian market, retailers are trying to aggressively foray region's low-cost daily-use retail segment. Idea is to enable a customer buy a range of products its for or less than Rs 99. This being the template, retailers have introduced nations to suit there business models. The store range of largely food, healthcare and products.

Home stores has gone a step further to introduce some interesting modifications to the basic idea of a dollar-and-dime store. "We believe that pricing all products at a flat Rs 99 will be a rigid approach. We have introduced four different price slabs to make it more attractive and reach a broader customer profile.

Homemaker's group has modified the idea even further by introducing bargain pricing on its products with the help of a two-digit price band. So customers visiting the Homemakers shops will not only get products between Rs 10 and Rs 99, they will also have more price positioning options.

Source: Adopted from The Economic Times, Dec. 16, 2005

fixed assets say for starting own retail outlets or engaging large number of sales force. Indirect selling through intermediary does not involve deployment of huge funds on these aspects. Thus, if the firm has plenty of funds it may go for direct distribution. If spare funds are not available, it may go for indirect channels.

Similarly if the management want to have greater control on the channel members, short channels are used but if the management do not want more control over the middlemen, it can go in for longer channel or large number of intermediaries.

3. Competitive Factors: The choice of channel is also affected by the channel selected by competitors in the same industry. If the competitor's have selected a particular channel say Chemist shops for the sale of toiletry products like hair oil, the other firm may also like to select the similar channel. In some cases producers may want to avoid the channels used by competitors. For example if other cosmetic producers have chosen big retail stores for the sale of their products, a particular firm may like to adopt door to door selling. Thus, it will depend upon the policy of the firm – whether it wants to go with the competitors or be different from them. The changing global marketing environment has lead to adoption of newer channels. (see box)

4. Market Factors: Important market factors affecting the choice of channel of distribution include size of market, geographical concentration of potential buyers and quantity purchased. In case the number of buyers is small, like for most industrial products, short channels are used. But if the number of buyers is large, as in case of most convenience products like soft drink, toothpaste etc., longer channels involving large number of intermediaries are used.

If the buyers are concentrated in a small place, short channels may be used but if the buyers are widely dispersed over a large geographical area, longer channels may be used. Similarly if the size of order is small, as in case of most consumer products, large number of intermediaries may be used. But if the size of order is large, direct channels may be used.

5. Environmental Factors: Other important factors affecting the choice of channels of distribution include environmental factor such as economic condition and legal constraints. In a depressed economy marketers use shorter channels to distribute their goods in an economical way.

Physical Distribution

Once goods are manufactured, packaged, branded, priced, and promoted, these must be made available to customers at the right place, in right quantity and at the right time. For example, a person convinced about the quality etc. of a product, say, a detergent bar, wants to purchase the same. He/She goes to a retail outlet and asks for the product. If that product is not available in that shop, he/she may purchase some of the alternative brand available. This way a sure sale is lost because goods were not available at the place where the customer wanted to purchase. Thus, it is an important responsibility of the marketers to make the product physically available at a place where the customers would like them to buy. The physical handling and movement of goods from place of production to the place of distribution is referred to as physical distribution, which is a very important element of marketing mix.

Physical distribution covers all the activities required to physically move goods from manufacturers to the customers. Important activities involved in the physical distribution include transportation, warehousing, material handling, and inventory control. These activities constitute major components of physical distribution.

Components of Physical Distribution

The main components of physical distribution are explained as follows:

1. Order Processing: In a typical buyer-seller relationship order placement is the first step. Products flow from manufacturers to customers via channel members while orders flow in the reverse direction, from customers to the manufacturers. A good physical distribution system should provide for an accurate and speedy processing of orders, in the absence of which goods would reach the customers late or in wrong quantity or specifications. This would result in customer dissatisfaction, with the danger of loss of business and goodwill.

2. Transportation: Transportation is the means of carrying goods and raw materials from the point of production to the point of sale. It is one of the major elements in the physical distribution of goods. It is important because unless the goods are physically made available, the sale cannot be completed.

3. Warehousing: Warehousing refers to the act of storing and assorting products in order to create time utility in them. The basic purpose of warehousing activities is to arrange placement of goods and provide facilities to store them. The need for warehousing arises because there may be difference between the time a product is produced and the time it is required for consumption. Generally the efficiency of a firm in serving its customers will depend on where these warehouses are located and where are these to be delivered.

Generally larger the number of warehouses a firm has, lesser would be the time taken in serving customers at different locations but greater would be the cost of warehousing and vice-versa. Thus the firm has to strike a balance between the cost of warehousing and the level of customer service.

For products requiring long-term storage (such as agricultural products) the warehouses are located near production sites. This helps in

Nothing Beats Word of Mouth in India

Nothing sways an Indian buyer's choice more than a word of reassurance from the people he knows. Now even high octane media blitz. A global online survey conducted by ACNielsen puts word of mouth communication and referencing as the biggest influence than conventional advertising on consumers in their buying decisions. In big ticket purchases like cars, mobile phones and home loans, the study says that almost 50% of consumers in India rely on the references from their friends and relatives while making their decisions.

The story is different in developed economies. Take the case of automobiles. In markets like the US, Canada and Japan more people are influenced by conventional advertising by automobile companies, in developing markets like India, Malaysia and Thailand it's the neighbour or the colleague who tips the scales one way or the other. "In case of luxury goods, the psyche of Indians has always been different. Buying a car is a family decision, so it is only natural that all the members of the family will talk to all the other users of a similar products, who they know", General Motors India director P Balendran said:

"No wonder, large automakers in India spend as much on customer satisfaction as advertising, and recognitions like the JD Power Customer Satisfaction awards taken so seriously."

When the whole world is going crazy with Internet and mobile marketing, it is interesting that for Indians it's still conventional advertising and word of mouth campaigns that sways their choices. Unlike in the West, Indians come from a very closely-knit society where people get influenced by their peers, relatives and local celebrities. People are more than willing to accept a brand if it's endorsed by their favourite superstar or is recommended by their close associates," AC Nielsen (south Asia) ED Sarang Panchal says:

"However, in markets like the US, previous experience with the products is the strongest influencer overall and particularly when it came to buying cars (49%), choosing a banks (46%), mobile phone (39%) and loans (35%). World of mouth is a priority while buying weight loss products and mobile phones."

Source: Adopted from Economic Times, Oct. 24, 2006

minimising the charges on transportation of the goods. On the other hand, the products which are bulky and hard to ship (machinery, automobiles) as well as perishable products (bakery, meat, vegetables) are kept at different locations near the market.

4. Inventory Control: Linked to warehousing decisions are the inventory decisions which hold key to success for many manufacturers, especially those where the perunit cost is high. A very important decision in respect of inventory is deciding about the level of inventory. Higher the level of inventory, higher will be the level of service to customers but the cost of carrying the inventory will also be high because lot of capital would be tied up in the stock. Thus, a balance is to be maintained in respect of the cost and customer satisfaction. With advancements in computers and information technology the need for keeping higher inventory is reducing and the new concept of Just-in-Time-Inventory decision is becoming popular in an increasing number of companies.

The decision regarding level of inventory involves prediction about the demand for the product. A correct estimate of the demand helps to hold inventory and cost level down to a minimum. This not only helps the firm in terms of the cash flows but also in terms of its ability to maintain production at a consistent level.

The major factors determining inventory levels include:

(a) firm's policy regarding the level of customer service to be offered. Higher the level of service greater will be the need to keep more inventories;

(b) degree of accuracy of the sales forecasts. In case more accurate estimates are available, the need for keeping very high level of inventory can be minimised;

(c) responsiveness of the distribution system i.e., ability of the system to transmit inventory needs back to the factory and get products in the market. In case the time required to respond to the additional demand for the products is high there is a need to maintain higher inventory. But if the additional demand can be met in less time, the need for inventory will also be low; and

(d) cost of inventory, which includes holding cost such as cost of warehousing, tied up capital, etc and the manufacturing cost.

Promotion

A company may produce a good quality product, price it appropriately and make it available at the selling points, which are convenient to customers. But in spite of all this, the product may not sell well in the market. There is a need for developing proper communication with the market. In the absence of communication, the customers would

Marketing Communications

not be able to know about the product and how it can satisfy their needs and wants or may not be convinced about its utility and benefits.

Promotion refers to the use of communication with the twin objective of informing potential customers about a product and persuading them to buy it. In other words, promotion is an important element of marketing mix by which marketers makes use of various tools of communication to encourage exchange of goods and services in the market.

Promotion Mix

Promotion mix refers to combination of promotional tools used by an organisation to achieve its communication objectives. Various tools of communication are used by the marketers to inform and persuade customers about their firm's products. These include: (i) Advertising, (ii) Personal Selling, (iii) Sales Promotion, and (iv) Publicity. These tools are also called elements of promotion mix and can be used in different combinations, to achieve the goals of promotion. For example consumer goods firms may use more of advertising through mass media while the industrial goods firms may be using more of personal selling. What combination of these elements is used by a firm will depend upon various factors such as nature of market, nature product, the promotions budget, objectives of promotion, etc. Let us first know about these elements in some details.

Advertising

We generally come across hundreds of advertising messages everyday, which tell us about various products such as toilet soaps, detergent powder, soft drinks and services such as hotels, insurance policies, etc.

Advertising is perhaps the most commonly used tool of promotion. It is an impersonal form of communication, which is paid for by the marketers (sponsors) to promote some goods or service. The most common modes of advertising are 'newspapers', 'magazines', 'television', and 'radio'.

The important distinguishing features of advertising are as follows:

(i) *Paid Form:* Advertising is a paid form of communication. That is, the sponsor has to bear the cost of

Advertising

"If you're trying to persuade people to do something, or buy something, it seems to me you should use their language, the language in which they think."

—David Ogilvy

"We find that advertising works the way the grass grows. You can never see it, but every week you have to move the lawn."

—Andy Travis

communicating with the prospects.

(ii) Impersonality: There is no direct face-to-face contact between the prospect and the advertiser. It is therefore, referred to as impersonal method of promotion. Advertising creates a monologue and not a dialogue.

(iii) Identified Sponsor: Advertising is undertaken by some identified individual or company, who makes the advertising efforts and also bears the cost of it.

Merits of Advertising

Advertising, as a medium of communication, has the following merits:

(i) Mass Reach: Advertising is a medium through which a large number of people can be reached over a vast geographical area. For example, an advertisement message placed in a national daily reaches lakhs of its subscribers.

(ii) Enhancing Customer Satisfaction and Confidence: Advertising creates confidence amongst prospective buyers as they feel more comfortable and assured about the product quality and hence feel more satisfied.

(iii) Expressiveness: With the developments in art, computer designs, and graphics, advertising has developed into one of the most forceful medium of communication. With the special effects that can be created, even simple products and messages can look very attractive.

(iv) Economy: Advertising is a very economical mode of communication if large number of people are to be reached. Because of its wide reach, the overall cost of advertising gets spread over numerous communication links established. As a result the per-unit cost of reach comes low.

Limitations of Advertising

The following are the major limitations of advertising as a tool of promotion:

(i) Less Forceful: Advertising is an impersonal form of communication. It is less forceful than the personal selling as there is no compulsion on the prospects to pay attention to the message.

(ii) Lack of Feedback: The evaluation of the effectiveness of advertising message is very difficult as there is no immediate and accurate feedback mechanism of the message that is delivered.

(iii) Inflexibility: Advertising is less flexible as the message is standardised and is not tailor made to the requirements of the different customer groups.

(iv) Low Effectiveness: As the volume of advertising is getting more and more expanded it is becoming difficult to make advertising messages heard by the target prospects. This is affecting the effectiveness of advertising.

Value AD

Government Shining

It's not the heavy weight in the FMCG sector which are ruling the roost as top advertisers on the tube, but surprisingly it's the government departments and public sector units. Apart from Procter & Gamble, Bajaj Consumer Care, Joyco and Eicher Motors, the list of top advertisers across television and print is dominated by Sarkari outfits flaunting their new found passion for mass-media led public communication.

Top Five Advertisers on Television

	Ad Time (in '000 seconds)
Procter & Gamble Home Products	799
Central Excise Department	375
West Bengal Information and Culture	275
Joyco India Ltd.	227
Bajaj Consumer Care Ltd.	165

Print

	Ad Volume (Col.com in'000)
Sikkim/Royal Govt. Of Bhutan	416
Ratan Ayurvedic Sansthan	388
Government Of Mizoram	251
Ministry Of Petroleum and Natural Gas	209
Eicher Motors Ltd.	157

Source: Adopted from The Economic Times

Objections to Advertising

In the proceeding sections, you have noted the merits and limitations of advertising. Though advertising is one of the most frequently used medium of promotion of goods and services, it attracts lot of criticism. The opponents of advertising say that the expenditure on advertising is a social waste as it adds to the cost, multiplies the needs of people and undermines social values. The proponents, however, argue that advertising is very useful as it increases the reach, brings the pay unit cost of production down and adds to the growth of the economy. It is therefore, important to examine the major criticisms against advertising and see the extent to which these are true. This is taken up as follows:

1. Adds to Cost: The opponents of advertising argue that advertising unnecessarily adds to the cost of product, which is ultimately passed on to the buyers in the form of high prices. An advertisement on TV, for a few seconds, for example, costs the marketers several lakhs of rupees. Similarly an advertisement in print media say in a newspaper or a magazine costs the marketers a large amount of money. The money spent adds to the cost, which in an important factor in fixation of the price of a product.

True, advertisement of a product costs lot of money but it helps to increase the demand for the product as large number of potential buyers come to know about the availability of the products, its features etc. and are persuaded to buy it. The increased demand leads to higher production, which brings with it the economies of scale. As a result, the per unit cost of production comes down as the total cost is divided by larger number of units. Thus, the expenditure on advertisement adds to the total cost but the per unit cost comes down which in fact lessens the burden of consumers rather than adding to it.

2. Undermines Social Values: Another important criticism of advertising is that it undermines social values and promotes materialism. It breeds discontent among people as they come to know about new products and feel dissatisfied with their present state of affairs. Some advertisements show new life styles, which don't find social approval.

This criticism is not entirely true. Advertisement in fact helps buyers by informing them about the new products, which may be improvement over the existing products. If the buyers are not informed about these products, they may be using inefficient products. Further, the job of an advertisement is to inform. The final choice to buy or not to buy anyway rests with the buyers. They will buy if the advertised product satisfies some of their needs. They may be motivated to work harder to be able to purchase these products.

3. Confuses the Buyers: Another criticism against advertisement is that so many products are being advertised which makes similar claims that the buyer gets confused as to which one is true and which one should be relied upon. For example, we may note similar claims of whiteness or stain removing abilities in competing brands of detergent powder or claims of whiteness of tooth or 'feelings of freshness' in competing brands of toothpaste that it is sometimes confusing to us as to which one to buy.

The supporters of advertisement, however, argue that we are all rational human beings who make our decisions for purchase of products on factors such as price, style, size, etc. Thus the buyers can clear their confusion by analysing the information provided on the advertisements and other sources before taking a decision to purchase a product. However, this criticism cannot be completely overruled.

4. Encourages Sale of Inferior Products: Advertising does not distinguish between superior and inferior products and persuade people to purchase even the inferior products.

In fact superiority and inferiority depends on the quality, which is a relative concept. The desired level of quality will depend on the economic status and preferences of the target customers. Advertisements sell products of a given quality and the buyers will buy if it suits their requirements. No advertisement should however, make false claim about the quality of a product. If a firm makes a false claims it can be prosecuted for the same.

5. Some Advertisements are in Bad Taste: Another criticism against advertising is that some advertise-ments are in bad taste. These show something which in not approved by some people say advertisements showing women dancing when not required or running after a man because he is wearing a particular suit or using a particular perfume are certainly not good. Some advertisements distort the relationship like employer employee and are quite offensive.

Celebrities' Influence on Brands' Performance

Example of ad campaigns featuring celebrities, which resulted in brand building and growth in volumes.

Cadbury's and Amitabh Bachchan: The commercial, a testimonial by Bachchan on a factory visit, was launched to rebuild the trust in the brand. Twelve weeks after the campaign was launched, the sales reached 90 per cent of volumes prior to the worm crisis. Big B's presence helped the company to get media coverage that added to the campaign's impact.

Santro and Shah Rukh Khan: Shah Rukh was roped in Santro ad to strike an immediate bond with the consumers. Shah Rukh Khan is an unconventional superhero with a quirky acting style that matched the image of Santro.

Titan and Aamir Khan: Both are considered to be Indian icons and have made a mark internationally; the obsession with detail is common to both, as also a sense of style. The Mangal Pandey look, which was unconventional, made the advertisement stand out, along with the fact that Aamir is less exposed than the other celebrities.

Munch and Rani Mukherjee: The campaign for Munch was aired on TV roped Rani Mukherjee to give "a big brand feel". The company got incredibly good result in recall and the ad was a big hit with kids. Rani was used as a consumer and not as a filmstar.

Sachin Tendulkar and Boost: Research indicated that the brand's association with Sachin has consistently been successful in strengthening the brand's core values and building brand stature. Kids look up to Sachin as a true hero, want to emulate everything that he does and can't seem to get enough of him.

Source: Adopted from Indian Journal of Marketing, Oct. 5, 2006

We have seen the views of the opponents and the proponents of advertising. There may be some chances of misuse of advertising as a tool, which can be properly safeguarded by the law or by developing a code of conduct by the advertisers, for their self regulation. However, most of the criticism against advertising are not entirely true. In the changed economic environment of globalisation, advertising is considered as an important tool of marketing. It helps a firm in effectively communicating with its target market, increasing the sale and there by reducing the per unit cost of production. It is not a social waste, rather it adds value to the social cause by giving a boost to production and generating employment.

Personal Selling

Personal selling involves oral presentation of message in the form of conversation with one or more prospective customers for the purpose of making sales. It is a personal form of communication. Companies appoint salespersons to contact prospective buyers and create awareness about the product and develop product preferences with the aim of making sale.

Features of Personal Selling

(i) *Personal Form:* In personal selling a direct face-to-face dialogue takes place that involves an interactive relationship between the seller and the buyer.

(ii) *Development of Relationship:* Personal selling allows a salesperson to develop personal relationships with the prospective customers, which may become important in making sale.

Merits of Personal Selling

(i) *Flexibility:* There is lot of flexibility in personal selling. The sales presentation can be adjusted to fit the specific needs of the individual customers.

(ii) *Direct Feedback:* As there is direct face-to-face communication in personal selling, it is possible to take a direct feed back from the customer and to adapt the presentation according to the needs of the prospects.

Personal Selling

'Most people think 'selling' is the same as 'talking'. But the most effective salespeople know that listening is the most important part of their job.'

—Roy Bartell

'You don't close a sale, you open a relationship if you want to build a long-term, successful enterprise.'

—Patricia Fripp

(iii) *Minimum Wastage:* The wastage of efforts in personal selling can be minimised as company can decide the target customers before making any contact with them.

Role of Personal Selling

Personal selling plays a very important role in the marketing of goods and services. The importance of personal selling to businessmen, customers and society may be described as below.

Importance to Businessmen

Personal selling is a powerful tool for creating demand for a firm's products and increasing their sale. The importance of personal selling to a business organisation may be described as follows:

(i) *Effective Promotional Tool:* Personal selling is very effective promotional tool, which helps in influencing the prospects about the merits of a product and thereby increasing its sale.

(ii) *Flexible Tool:* Personal selling is more flexible than other tools of promotion such as advertising and sales promotion. It helps business persons in adopting their offer in varying purchase situations.

(iii) *Minimises Wastage of Efforts:* Compared with other tools of promotion, the possibility of wastage of efforts in personal selling is minimum. This helps the business persons in bringing economy in their efforts.

(iv) *Consumer Attention:* There is an opportunity to detect the loss of consumer attention and interest in a personal selling situation. This helps a business person in successfully completing the sale.

(v) *Lasting Relationship:* Personal selling helps to develop lasting relationship between the sales persons and the customers, which is very important for achieving the objectives of business.

(vi) *Personal Rapport:* Development of personal rapport with customers increases the competitive strength of a business organisation.

(vii) *Role in Introduction Stage:* Personal selling plays very important role in the introduction stage of a new product as it helps in persuading customers about the merits of the product.

(viii) *Link with Customers:* Sales people play three different roles, namely persuasive role, service role and informative role, and thereby link a business firm to its customers.

Importance to Customers

This role of personal selling becomes more important for the illiterate and rural customers, who do not have many other means of getting product information.

The customers are benefited by personal selling in the following ways:

(i) Help in Identifying Needs: Personal selling helps the customers in identifying their needs and wants and in knowing how these can best be satisfied.

(ii) Latest Market Information: Customers get latest market information regarding price changes, product availability and shortages and new product introduction, which help them in taking the purchase decisions in a better way.

(iii) Expert Advice: Customers get expert advice and guidance in purchasing various goods and services, which help them in making better purchase.

(iv) Induces Customers: Personal selling induces customers to purchase new products that satisfy their needs in a better way and thereby helps in improving their standards of living.

Importance to Society

Personal selling plays a very productive role in the economic progress of a society. The more specific benefits of personal selling to a society are as follows:

(i) Converts Latest Demand: Personal selling converts latest demand into effective demand. It is through this cycle that the economic activity in the society is fostered, leading to more jobs, more incomes and more products and services. That is how economic growth is influenced by personal selling.

(ii) Employment Opportunities: Personal selling offers greater income and employment opportunities to the unemployed youth.

(iii) Career Opportunities: Personal selling provides attractive career with greater opportunities for advancement and job satisfaction as well as security, respect, variety, interest and independence to young men and women.

(iv) Mobility of Sales People: There is a greater degree of mobility in sales people, which promote travel and tourism in the country.

(v) Product Standardisation: Personal selling increases product standardisation and uniformity in consumption pattern in a diverse society.

Sales Promotion

Sales promotion refers to short-term incentives, which are designed to encourage the buyers to make immediate purchase of a product or service. These include all promotional efforts other than advertising, personal selling and publicity, used by a company to boost its sales. Sales promotion activities include offering cash discounts, sales contests, free gift offers, and free sample distribution. Sales promotion is usually undertaken to supplement other promotional efforts such as advertising and personal selling.

Companies use sales promotion tools specifically designed to promote to customers (e.g., free samples, discounts, and contests), tradesmen or middlemen (e.g., cooperative advertising, dealer discounts and dealer incentives and contests) and to sales person (e.g., bonus, salesmen contests, special offers). Sales promotions include only those activities that are used to provide short term incentives to boost the sales of a firm.

Merits of Sales Promotion

(i) *Attention Value:* Sales promotion activities attract attention of the people because of the use of incentives.

(ii) *Useful in New Product Launch:* Sales promotion tools can be very effective at the time of introduction of a new product in the market. It induces people to break away from their regular buying behaviour and try the new product.

(iii) *Synergy in Total Promotional Efforts:* Sales promotion activities are designed to supplement the personal selling and advertising efforts used by a firm and add to the over all effectiveness of the promotional efforts of a firm.

Limitation of Sales Promotion

(i) *Reflects Crisis:* If a firm frequently rely on sales promotion, it may give the impression that it is unable to manage its sales or that there are no takers of its product.

(ii) *Spoils Product Image:* Use of sales promotion tools may affect the image of a product. The buyers may start feeling that the product is not of good quality or is not appropriately priced.

Commonly used Sales Promotion Activities

1. Rebate: Offering products at special prices, to clear off excess inventory. Example, a car manufacturer's offer to sell a particular brand of car at a discount of Rs 10,000, for a limited period.

2. Discount: Offering products at less than list price. Example, a shoe company's offer of 'Discount Up to 50%' or a shirt marketer's offer of '50+40% Discount'.

3. Refunds: Refunding a part of price paid by customer on some proof of purchase, say on return of empty foils or wrapper. This is commonly used by food product companies, to boost their sales.

4. Product Combinations: Offering another product as gift along with the purchase of a product, say offer of a pack of □ kg of rice with the purchase of a bag of Aatta (wheat flour), or 'Get 128 KB Memory Card Free with a Digicam' or Buy a TV of 25+ and Get a Vacuum Cleaner Free' or '100 Gm Bottle of Sauce Free With 1 kg Detergent.'

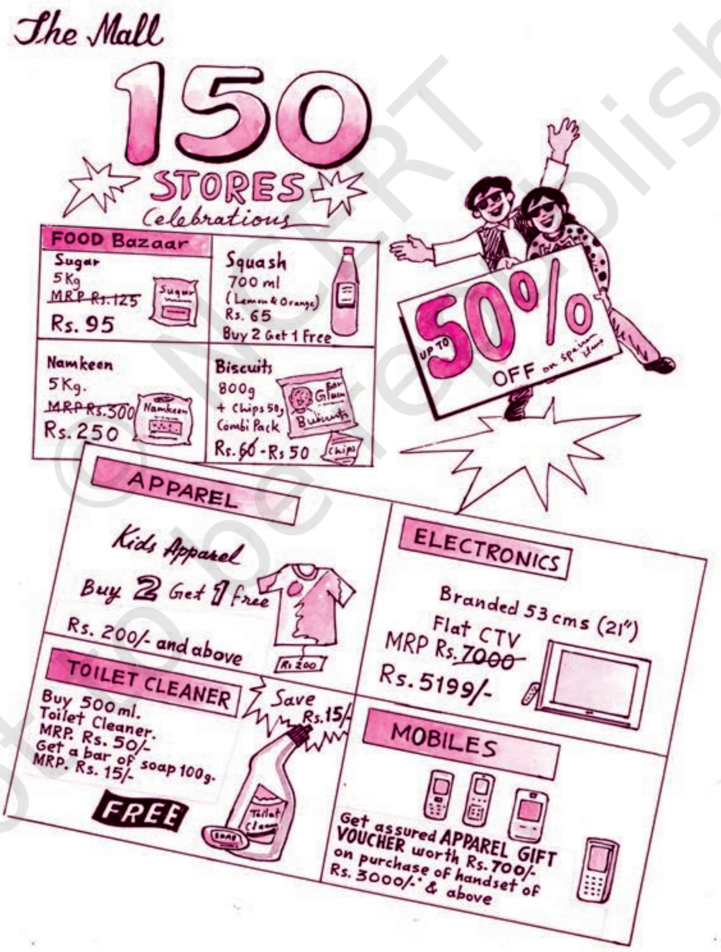
5. Quantity Gift: Offering extra quantity of the product commonly used by marketer of toiletry products. For example, a shaving cream's offer of '40% Extra' or A Hotel's offer of

"Take a 2 Night 3 Days Package At the Hotel and Get an Extra Night Stay At Just Rs 500" or 'Buy 2 Get 1 Free' offer of a marketer of shirts.

6. Instant Draws and Assigned Gift: For example, 'Scratch a Card' or 'Burst a Cracker' and instantly win a Refrigerator, Car, T-shirt, Computer, with the purchase of a TV.

7. Lucky Draw: For example, the offer of a bathing soap to win a gold coin on lucky draw coupon for free petrol on purchase of certain quantity of petrol from given petrol pump or lucky draw coupon on purchase of easy undergarment and win a car offer.

8. Usable Benefit: 'Purchase goods worth Rs 3000 and get a holiday package worth Rs 3000 free' or 'Get a Discount Voucher for Accessories on Apparel Purchase of Rs 1000 and above.'



Sales Promotion

9. Full finance @ 0%: Many marketers of consumer durables such as Electronic goods, automobiles etc offer easy financing schemes such as '24 easy instalments, Eight Up Front and 16 To Be Paid as Post Dated Cheques'. However, one should be careful about the file charges, which sometimes is nothing but interest recovered in advance.

10. Sampling: Offer of free sample of a product, say a detergent powder or tooth paste to potential customers at the time of launch of a new brand.

11. Contests: Competitive events involving application of skills or luck, say salving a quiz or answering some questions.

Publicity

Publicity is similar to advertising, in the sense that it is a non-personal form of communication. However, as against advertising it is a non-paid form of communication. Publicity generally takes place when favourable news is presented in the mass media about a product or service. For example, if a manufacturer achieves a breakthrough by developing a car engine, which runs on water instead of petrol, and this news is covered by television or radio or newspapers in the form of a news item. It would be termed as publicity because the engine manufacturer would benefit from such dissemination of information about its achievement by the media but would not bear any cost for the same. Thus, the two important features of publicity are that:

(i) Publicity is an unpaid form of communication. It does not involve any direct expenditure by the marketing firm; and

(ii) There is no identified sponsor for the communication as the message goes as a news item.

In publicity, as the information is disseminated by an independent source, e.g., the press in the form of news stories and features, the message has more credibility than if that comes as a sponsored message in advertising.

Also, as the message goes in the form of a news rather than direct sales communication, it can reach even to those persons who otherwise may not pay attention to paid communication.

However, an important limitation of publicity is that as a medium of promotion, it is not within the control of a marketing firm. The media would cover only those pieces of information, which are news worthy and which symbolise some achievement in the field. Thus, a firm can't use publicity to actively promote its products.

Public Relations

Managing public opinion of an organisation is an important task which can be performed by the marketing department. The business needs to communicate effectively to customers, suppliers, and dealers, since they are instrumental in increasing the sales and profit. Besides those who come into direct contact with the organisation or its products, there are other members of the general public whose voice or opinion is equally important. This public may be interested in the company and its product and have an impact on the business ability to achieve its objectives. Thus, it becomes imperative to manage public opinion and the company's relation with the public on a regular basis. Therefore, public relations involve a variety of programmes designed to promote or protect a company's image and its individual products in the eyes of the public.

The business relates with a number of groups including suppliers, shareholders, intermediaries, activist groups, and the government. For example, active support of middlemen is needed if the firm wants to survive in a competitive selling environment. Similarly, consumer activist groups need to be satisfied because they can impose restriction on the sales of the firm's products directly by urging customers to refrain from buying them or through the imposition of laws. Most organisations, business or otherwise nowadays, have a separate department to manage public relations. They may also utilize the services of any outside public relations agency.

Their main task is to disseminate information and build goodwill about the business. Concrete steps are to be taken to monitor the attitude of the general public and generate positive publicity. They are especially useful when there is negative publicity about the company or its products. At that time, the situation has to be tackled like an emergency to improve public image. The public relations department then has to do something drastic so that damage to company's images is controlled and minimised. They also advise top management to adopt certain programmes which will add to their public image and ensure that negative publicity does not take place at all.

Role of Public Relations

The role of public relations can be discussed with respect to the functions which the department performs. Public relations itself is an important tool in the hands of the marketing department, which can be used to the advantage of the business. The public relations department performs five functions:

1. **Press relations:** Information about the organisation needs to be presented in a positive manner in the press. Generating news requires skill in developing and researching a story and getting the media to accept press releases is a difficult task. The public relations department is in contact with the media to present true facts and a correct picture about the company. Otherwise news can get distorted if taken from other sources.
2. **Product publicity:** New products require special effort to publicise them and the company has to sponsor such programmes. The public relations department manages the sponsoring of such events. The company can draw attention to new products by arranging sports and cultural events like news conferences, seminars and exhibitions.

3. **Corporate Communication:** The image of the organisation needs to be promoted through communicating with the public and the employees within the organisation. This is usually done with the help of newsletter, annual reports, brochures, articles and audio-visual materials. Companies rely on these materials to reach and influence their target markets. Speeches by the company's executives at a meeting of trade associations or trade fairs can really boost the company's image. Even interviews with TV channels and responding to queries from the media go a long way in promoting public relations.

4. **Lobbying:** The organisation has to deal with government officials and different ministers in charge of corporate affairs, industry, finance with respect to policies relating to business and the economy. The government also seeks to maintain a healthy relationship with associations of commerce and industry and solicits the opinion of major stakeholders while formulating industrial, telecom, taxation policies, etc. The public relations department then has to be really proactive in promoting or decoding regulations that affect them.

5. **Counselling:** The public relations department advises the management on general issues which affect the public and the position the company would like to the take on a particular issue. The company can build goodwill by contributing money and time to certain causes like environment, wildlife, children's rights, education, etc. Such cause-related activities help in promoting public relations and building goodwill.

In addition, maintaining good public relations also helps in achieving the following marketing objectives:

(a) **Building awareness:** Public relations department can place stories and dramatise the product in the media. This will build marketplace excitement before the product reaches the market or media advertising takes place. This usually creates a favourable impression on the target customer.

(b) **Building credibility:** If news about a product comes in the media whether print or electronic it always lends credibility and people believe in the product since it is in the news.

(c) **Stimulates sales force:** It becomes easier for the sales force to deal with the retailers and convince dealers if they have already heard about the product in the news before it is launched. Retailers and dealers also feel it is easier to sell the product to the ultimate consumer.

(d) **Lowers promotion costs:** Maintaining good public relations costs much less than advertising and direct mail. However, it requires a lot of communication and interpersonal skills to convince the media to give space or time for the organisation and its product.

The major differences between advertising and personal selling are as follows:

Difference between Advertising and Personal Selling

S. No.	Advertising	Personal Selling
1.	Advertising is an impersonal form of communication.	Personal selling is a personal form of communication.
2.	Advertising involves transmission of standardised messages, i.e., same message is sent to all the customers in a market segment.	In personal selling, the sales talk is adjusted keeping view customer's background and needs.
3.	Advertising is inflexible as the message can' t be adjusted to the needs of the buyer.	Personal selling is highly flexible. as the message can be adjusted.
4.	It reaches masses, i.e., a large number of people can be approached.	Only a limited number of people can be contacted because of time and cost considerations.
5.	In advertising the cost per person reached is very low.	The cost per person is quite high in the case of personal selling.
6.	Advertising can cover the market in a short time.	Personal selling efforts take a lot of time to cover the entire market.
7.	Advertising makes use of mass media such television, radio, newspaper, and magazines.	Personal selling makes use of sales staff, which has limited reach.
8.	Advertising lacks direct feedback. Marketing research efforts are needed to judge customers' reactions to advertising.	Personal selling provides direct and immediate feed back. Sales persons come to know about the customers' reactions immediately.
9.	Advertising is more useful in creating and building interest of the consumers in the firms products.	Personal selling plays important role at the awareness stage of decision making.
10.	Advertising is more useful in marketing to the ultimate consumer's who are large in numbers	Personal selling is more helpful in selling products to the industrial buyers or to intermediaries such as dealers and retailers who are relatively few in numbers.

Key Terms

Marketing	Brand Mark	Market Packaging
Marketing Management	Labelling	Marketing Mix
Channels of Distribution	Marketing Offering	Physical Distribution
Consumer Product	Promotion	Industrial Product
Promotion Mix	Convenience Product	Advertising
Shopping Product	Personal Selling	Speciality Product
Publicity	Generic Name	Sales Promotion
Brand	Brand Name	Trade Mark

SUMMARY

In the traditional sense, the term 'market' refers to the place where buyers and sellers gather to enter into transactions involving the exchange of goods and services. But in modern marketing sense, it refers to a set of actual and potential buyers of a product or service.

What is Marketing: The term marketing has been described as performance of business activities that direct the flow of goods and services from producers to consumers. Marketing is not merely a post-production activity. It includes many activities that are performed even before goods are actually produced and continue even after the goods have been sold.

In Modern Times: Marketing is described as a social process by which individual groups obtain what they need and want through creating offerings and freely exchanging products and services of value with others. Marketing is not merely a business phenomena or confined only to business organisations. Marketing activities are equally relevant to non-profit organisations

What can be Marketed: Anything that is of value to the other can be marketed. It can be a product or a service or a person or a place or an idea. It can also be an experience, properties, events, information or organisation.

Marketing management means management of the marketing function. It refers to 'The art and science of choosing target markets and getting, keeping and growing customers through creating, delivering and communicating superior customer value of management.'

Marketing and Selling: Many people confuse 'selling' for 'marketing'. However, selling is only a part of the process of marketing. The main focus of selling is on affecting transfer of title and possession of goods from sellers to users. Marketing activities put greater thrust on maximising customer's satisfaction.

Marketing Management Philosophies: The different business philosophies or concepts guiding the marketing efforts are: (i) *Production Concept* which assumes that availability and affordability of the product are the key to the success of a firm and puts greater emphasis on improving the production and distribution efficiency of the firms. (ii) *Product Concept* assumes that product improvement is, the key to profit maximisation of a firm; (iii) *Sales Concept* assumes that the customers would not buy, or not buy enough, unless they are adequately convinced and motivated to do so, It is believed that aggressive selling and promotional efforts are important to make customers buy their products. (iv) *Marketing Concept* implies that focus on satisfaction of customer's needs is the key to the success of any organisation in the market. (v) *The Societal Marketing Concept* is the extension of the marketing concept as supplemented by the concern for the long-term welfare of the society.

Functions of Marketing: The important functions of marketing include Gathering and Analysing Market Information, Marketing Planning, Product Designing and Development, Standardisation and Grading, Packaging and Labelling, Branding, Customer Support Services, Pricing of Products, Promotion, Physical distribution, Transportation, Storage or Warehousing.

Role of Marketing: By adopting marketing orientation, an organisation whether profit making or non-profit making, can achieve its goals in the most effective manner. Also marketing acts as a catalyst in the economic development of a country and helps in raising the standards of living of people.

Marketing Mix is a set of marketing tools that the firm uses to pursue its marketing objectives in a target market. The variables or elements of marketing mix have been classified in to four categories, popularly known as four Ps of marketing viz., Product, Price, Place and Promotion. These elements are combined to create an offer.

Product: In common parlance, the word 'product', is used to refer only to the physical or tangible attributes of a product. In marketing, product is a mixture of tangible and intangible attributes, which are capable of being exchanged for a value, with ability to satisfy customer needs. It is anything that can be offered to a market to satisfy a want or need. Products may broadly be classified into two categories—industrial products and consumers' products. Products, which are purchased, by the ultimate consumers or users for satisfying their personal needs and desires are referred to as consumer products. On the basis of shopping efforts involved, the products are classified as Convenience Product, Shopping Products and Speciality Products. On the basis of their durability, consumer products have been classified into categories—Durable, Non-durable and Services.

Those activities, benefits or satisfactions, which are offered for sale, e.g., dry cleaning, watch repairs, hair cutting, are called services.

Industrial products are those products, which are used as inputs in producing other products. These are broadly classified in to (i) Materials and Parts, (ii) Capital Items, and (iii) Supplies and Business Services.

Generic name refers to the name of the whole class of the product. For example, a book, a wristwatch, and tyre. A brand is a name, term, sign, symbol, design or some combination of them, used to identify the products—goods or services of one seller or group of sellers and to differentiate them from those of the competitors. That part of a brand, which can be spoken, is called a brand name.

That part of a brand which can be recognized but which is not utter able is called brand mark. Brand mark appears in the form of a symbol, design, distinct colour scheme or lettering. Brand or part of a brand that is given legal protection is called trademark.

A good brand name should be short, easy to pronounce, spell, recognize and remember; Should suggest the product's benefits and qualities; be distinctive; be adaptable to packing or labelling requirements; be sufficiently versatile to accommodate new products; be capable of being registered and protected legally and have staying power i.e. it should not get out of date.

Packaging: The act of designing and producing the container or wrapper of a product is referred as packaging. There can be three different levels of packaging. viz Primary package, Secondary packaged, Transport package. Packaging performs a number of functions in the marketing of goods. Some of the important functions, include Product identification; Product protection; Facilitating the use of the product and Promotion of goods and services.

Labelling: A simple looking but important task in the marketing of goods relates to designing the label to be put on the package. The label may vary from a simple tag attached to the product to complex graphics that are part of the package. The most important functions of labels include i) describing the product ii) help in identifying the product or brand; iii) help in grading the products into different categories; and aids in promotion of the products.

Pricing: Price may be defined as the amount of money paid by a buyer or received by a seller in consideration of the purchase of a product or service. Generally, if the price of a product is increased, its demand comes down, and vice-versa. Pricing is considered to be an effective competitive weapon. It is also the single most important factor affecting the revenue and profits of a firm.

The factors affecting price determination are (i) Product Cost (ii) The Utility and Demand (iii) Competition (iv) Government and Legal Regulations and v) Marketing Methods Used.

Physical Distribution: There are two important decisions relating to this aspect- one regarding physical movement of goods and two, regarding the channels.

Channels of Distribution are set of firms and individuals that take title, or assist in transferring title, to particular goods or services as it moves from the producers to the consumers. Channels of distribution smoothen the flow of goods by creating possession, place and time utilities. The important functions performed by middlemen are: (i) Sorting; (ii) accumulation; (iii) allocation; (iv) assorting; (v) product promotion; (vi) negotiation; and (vii) risk taking:

Types of Channels: (I) Direct distribution channels are those where in the goods are made directly available by the manufacturers to customers, without involving any intermediary; include (II) Indirect Distribution Channels include i. Manufacturer - Retailer – Consumer (One Level Channel) ii. Manufacturer - Wholesaler - Retailer- Consumer (Two Level Channel) iii. Manufacturer - Agent - Retailer- Consumer (Three Level Channel) Factors Determining Choice of Channels include i. Product Related Factors; ii. Company Characteristics iii. Competitive Factor iv. Market Factor; and v. Environmental Factor.

Physical Distribution Covers all the activities required to physically move goods from manufacturers to the customers. The main component of physical distribution are. i. Order Processing; ii. Transportation; iii. Warehousing; and iv. Inventory Control: Just-in-Time-Inventory.

Promotion: Promotion refers to the use of communication with the twin objective of informing potential customers about a product and persuading them to buy it. There are four major tools, or elements of promotion mix, which are. (i) Advertising, (ii) Personal Selling, (iii) Sales Promotion, and (iv) Publicity. These tools are used in different combinations to achieve the goals of promotion.

Advertising is the most commonly used tool of promotion. It is an impersonal form of communication, which is paid for by the marketers (Sponsors) to promote some goods or service. The merits of advertising, as a medium of communication, include i. Mass reach ; ii. Enhancing customer satisfaction and confidence iii. Expressiveness; and iv. Economy

The limitations of advertising are that it is (i) less forceful (ii) lacks Feedback (iii) inflexibility (iv) low effectiveness The most common Objections to Advertising are that it i. adds to cost; ii. undermines social Values; iii. confuses the buyers; and iv. encourages sale of Inferior Products:

Most of the criticisms against advertising are not fully true. Advertising is therefore considered an essential function of marketing.

Personal Selling involves oral presentation of message in the form of conversation with one or more prospective customers for the purpose of making sales. Personal Selling plays important role for the business persons as well as for the society

Sales Promotion refers to short-term incentives, which are designed to encourage the buyers to make immediate purchase of a product service. These include promotional efforts other than advertising, personal selling and publicity, used by a company to boost its sales. Commonly used *Sales Promotion* Activities include Rebate, Discount, Refunds, Product Combinations, Quantity Gift, Instant Draws and Assigned Gift, Lucky Draw, Usable Benefit, Full Finance @ 0%, sampling, and contests

Publicity is similar to advertising, in the sense that it is a non-personal form of communication. However, as against advertising it is a non-paid form of communication. In publicity, as the information is disseminated by an independent source. However, an important limitation of publicity is that as a medium of promotion, it is not within the control of a marketing firm.

EXERCISES

Very short answer questions

(i) Explain the advantages of branding to marketers of goods and services.

(ii) List the characteristics of a good brand name.

(iii) What is the societal concept of marketing?

(iv) List the characteristics of convenience products.

(v) Enlist the advantages of packaging of a consumer products.

(vi) What are the limitations of a advertising as a promotional tool? Enlist

(vii) List five shopping products purchased by you or your family during the last few months.

Short answer question

(i) What is marketing ? What functions does it perform in the process of exchange of goods and services? Explain.

(ii) Distinguish between the product concept and production concept of marketing.

(iii) Product is a bundle of utilities? Do you agree? Comment.

(iv) What are industrial products? How are they different from consumer products? Explain.
(v) Distinguish between convenience product and shopping product.
(vi) 'Products is a mixture of tangible and intangible attributes'. Discuss
(vii) Describe the functions of labeling in the marketing of products.
(viii) Discuss the role of intermediaries in the distribution of consumer non durable products.
(ix) Explain the factors determining choice of channels of distribution.
(x) Explain briefly the components of physical distribution.
(xi) Define advertising. What are its main features? Explain.
(xii) Discuss the role of 'sales promotion' as an element of promotion mix.

Long answer type questions

(i) Define Marketing. How is it different from selling? Discuss.
(ii) What is the Marketing concept? How does it help in the effective marketing of goods and services.
(iii) What is marketing mix? What are its main elements? Explain.
(iv) How does branding help in creating product differentiation? Does it help in marketing of goods and services? Explain.
(v) What are the factors affecting determination of the price of a product or service? Explain.
(vi) What do you mean by 'channels of distribution' ? What functions do they play in the distribution of goods and services? Explain.
(vii) Explain the major activities involved in the physical distribution of products.
(viii) 'Expenditure on advertising is a social waste.' Do you agree? Discuss.
(ix) Distinguish between advertising and personal selling.

Projects/Assignment

(i) Visit in a team of four-five students to different marketing organisations in your locality (retailers, wholesalers, distributors, etc). Find what marketing activities are undertaken by them. Do you find any difference in the activities in the organisations visited by you? What common activities are found in these organisations? Write a report.
(ii) Collect ten advertisements appearing in newspapers, magazines, etc about recent sales promotional schemes about some consumers durable

or non durable products of your choice. Also collect some promotional material about these products written on the package of these products (cartons/wrappers/bottles, etc.) and write important features of the scheme in your notebook. Make a presentation in your class about the sales promotional schemes.

Application based questions

(i) As marketing manager of a big hotel located at an important tourist destination, what societal concerns would be faced by you and what steps would you plan to take care of these concerns? Discuss.

(ii) Suppose you are the marketing vice president of an insurance company, planning to design a new mediclaim policy for senior citizens. What information would you like to collect to perform this task and how will you collect such information? Discuss.

(iii) What shopping products have been purchased by you/your family in the last six months. Make a list and specify what factors influenced the purchase of each of these products.

(iv) What information is generally placed on the package of a food product. Design a label for one of the food products of your choice.

(v) For buyers of consumer durable products, what 'customer care services' would you plan as a manager of a firm marketing new brand of motorcycle. Discuss.

Case Problems

Nokia takes four-lane road to consumers.

NEW DELHI: After having grabbed a king-size 79% share of the Rs 15,000-crore mobile handset market in India, Nokia India has found a new way of connecting people.

The mobile handset manufacturer has embarked upon a brand new retail strategy that is based on a classification of its consumers into four major groups that separates people in terms of usage, income level and lifestyle.

The classification is based on an extensive survey– the Nokia Segmentation Study —that was carried over two years involving 42,000 consumers from 16 countries. It studied the impact lifestyle choices and attitudes have on the mobile devices consumers buy and how they use them.

The strategy, which was announced globally in June last year, is being unfolded in India now. While the nitty-gritty of the new strategy is still being worked out, it is likely that the company would follow separate marketing strategies for the four different segments. The advertising campaigns could be different for the segments.

Nokia's entire product portfolio has now been re-aligned towards these four groups to address the specific needs of each. The first of these segments Live, aimed a first time users whose basic need is to stay in touch with voice as the main driver, would have basic handsets low on features and price.

"These may be functional phones but the target group for these phones range from SEC C (low socio-economic class) to SEC A1+ (very high socio-economic class) markets," says Nokia India marketing head Devinder Kishore. The second segment Connect looks at more evolved users who look for more functionality and features and connectivity. Accordingly, phones in this segment would have GPRS, camera and music capabilities.

The next two categories, Achieve and Explore, are aimed at high-end users and have Nokia's top-end handsets. For example, Achieve segment looks at enterprise users who need to have business functionalities in their phones. Nokia's new E-series has been put under this segment with handsets having QWERTY keyboards and full Internet capabilities.

Aimed at high-end lifestyle users, Explore would be the most prominent segment for the company in the coming years. Says Nokia India multimedia business director Vineet Taneja, "This segment would see the most vibrant growth in the coming year. It will look at five different areas – applications, imaging, mobile TV, music and gaming. We are fast developing the ecosystem to support these areas."

Nokia acquired music solution and content provider LoudEye and GPS solution provider Gate5. It is all slated to launch its most high-profile handset, which boasts of having a 5 mega pixel camera and GPS capabilities apart from iPod quality music, in February.

Says Taneja, "There is increasing demand for convergence and multiple functionalities in high-end handsets. The N-series will try to address that." Nokia feels that the new platform strategy wherein different handsets are launched under a platform, like the N-Series, will become a status and style statement and drive numbers.

Source: www.economictimes.indiatimes.com

Questions

1. Identify the four market segments that Nokia plans to address as per the news report above.
2. What is the basis of classification of the market used by the company?
3. What do you mean by realignment of product portfolio? Illustrate this from the case above.
4. Identify the points that can be highlighted in marketing campaigns for each segment.
5. What are the different considerations in the mind of consumers of each segment while purchasing mobile phones as given in the above case?

CHAPTER 12

CONSUMER PROTECTION

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- state the importance of consumer protection;
- briefly explain legal framework for consumer protection in India;
- describe consumer rights in India;
- list out consumer responsibilities;
- briefly describe the ways and means of consumer protection; and
- describe the role of consumer organisations and NGOs in protecting consumers' interests.

MAHARASHTRA CONSUMER COMMISSION SLAPS FINE OF RS ONE LAKH ON COCA COLA

The Maharashtra State Consumer Commission has asked Coca Cola, one of the international fizzy drinks manufacturer, its bottler and distributor to pay Rs one lakh in damages to a consumer who found impurities in a bottle of soft drink that he had bought.

Chandrashekhar Paradkar, a resident of Shankar Nagar area here, filed a complaint with the Nagpur district Consumer Grievances Fourm seeking compensation of Rupees four lakh after he found some solid objects inside a sealed bottle of a soft drink. He had bought six various brands of the soft drink— two bottles each of Mazaa, Coca Cola and Sprite from a shop near his house.

Based on that, the District Forum earlier gave a ruling after finding Coca Cola, its bottlers Superior Drinks Pvt. Ltd. and distributors Balaji Sales guilty of supplying drinks unfit for human consumption, which was upheld by the State Consumer Commission.

The District Forum had found objects resembling pieces of mosquito repellent mats floating inside the sealed bottle. Having conducted the tests by a Public Health Laboratory, they found the drink unfit for human consumption.

The District Forum came down heavily on the company saying multinational giants would not be allowed to have a free run and exploit a poor country like India by manufacturing and marketing sub-standard products.

While giving its ruling, the District Forum relied upon the historic Donald versus Stevenson case, wherein heavy compensation had been awarded to a consumer, who had found rusted nails inside a bottle of ginger beer.

Source: http://www.indlaw.com/guest/news

The above case is just one of the examples of the many problems that consumers might have to face in the purchase, use and consumption of goods and services. The case also highlights the need for an appropriate legal protection to be provided to consumers to protect them from various forms of exploitation from the seller. Have you ever thought what would be the plight of consumers if adequate protection is not provided to them? Can the present day businesses afford to ignore the interests of consumers? The area of consumer protection has emerged as a very important area of study having significance for both the consumers and businesses alike.

Introduction

A consumer is said to be a king in a free market economy. The earlier approach of *caveat emptor*, which means "Let the buyer beware", has now been changed to *caveat venditor* ("Let the seller beware"). However, with growing competition and in an attempt to increase their sales and market share, manufacturers and service-providers may be tempted to engage in unscrupulous, exploitative and unfair trade practices like defective and unsafe products, adulteration, false and misleading advertising, hoarding, black-marketing etc. This means that a consumer might be exposed to risks due to unsafe products, might suffer from bad health due to adulterated food products, might be cheated because of misleading advertisements or sale of spurious products, might have to pay a higher price when sellers engage in overpricing, hoarding or black-marketing etc. Thus, there is a need for providing adequate protection to consumers against such practices of the sellers. Let us now discuss the importance of consumer protection.

Importance of Consumer Protection

Consumer Protection has a wide agenda. It not only includes educating consumers about their rights and responsibilities, but also helps in getting their grievances redressed. It not only requires a judicial machinery for protecting the interests of consumers but also requires the consumers to get together and form

Compensation for impurities in cold drinks

themselves into consumer associations for protection and promotion of their interests. At the same time, consumer protection has a special significance for businesses too.

From Consumers' point of view

The importance of consumer protection from the consumers' point of view can be understood from the following points:

(i) Consumer Ignorance: In the light of widespread ignorance of consumers about their rights and reliefs available to them, it becomes necessary to educate them about the same so as to achieve consumer awareness.

(ii) Unorganised Consumers: Consumers need to be organised in the form of consumer organisations which would take care of their interests. Though, in India, we do have consumer organisations which are working in this direction, adequate protection is required to be given to consumers till these organisations become powerful enough to protect and promote the interests of consumers.

(iii) Widespread Exploitation of Consumers: Consumers might be exploited by unscrupulous, exploitative and unfair trade practices like defective and unsafe products, adulteration, false and misleading advertising, hoarding, black-marketing etc. Consumers need protection against such malpractices of the sellers.

From the point of view of Business

A business must also lay emphasis on protecting the consumers and adequately satisfying them. This is important because of the following reasons:

(i) Long-term Interest of Business: Enlightened businesses realise that it is in their long-term interest to satisfy their customers. Satisfied customers not only lead to repeat sales but also provide good feedback to prospective customers and thus, help in increasing the customer-base of business. Thus, business firms should aim at long-term profit maximisation through customer satisfaction.

(ii) Business uses Society's Resources: Business organisations use resources which belong to the society. They, thus, have a responsibility to supply such products and render such services which are in public interest and would not impair public confidence in them.

(iii) Social Responsibility: A business has social responsibilities towards various interest groups. Business organisations make money by selling goods and providing services to consumers. Thus, consumers form an important group among the many stakeholders of business and like other stakeholders, their interest has to be well taken care of.

(iv) Moral Justification: It is the moral duty of any business to take care of consumer's interest and avoid any form of their exploitation. Thus, a business must avoid unscrupulous, exploitative and unfair trade practices like defective and unsafe products, adulteration, false and misleading advertising, hoarding, black marketing etc.

(v) Government Intervention: A business engaging in any form of exploitative trade practices would invite government intervention or action. This can impair and tarnish the image of the company. Thus, it is advisable that business organisations voluntarily resort to such practices where the customers' needs and interests will well be taken care of.

In view of the above, the government of India has enacted several regulations designed to provide adequate protection to consumers. We shall now discuss some of these regulations.

Legal Protection to Consumers

The Indian legal framework consists of a number of regulations which provide protection to consumers. Some of these regulations are as under.

1. The Consumer Protection Act, 1986: The Consumer Protection Act, 1986 seeks to protect and promote the interests of consumers. The Act provides safeguards to consumers

Protection against malpractices and exploitation

against defective goods, deficient services, unfair trade practices, and other forms of their exploitation. The Act provides for the setting up of a three-tier machinery, consisting of District Forums, State Commissions and the National Commission. It also provides for the formation of consumer protection councils in every District and State, and at the apex level.

2. The Indian Contract Act, 1872: The Act lays down the conditions in which the promises made by parties to a contract will be binding on each other. The Act also specifies the remedies available to parties in case of breach of contract.

3. The Sale of Goods Act, 1930: The Act provides some safeguards and reliefs to the buyers of the goods in case the goods purchased do not comply with express or implied conditions or warranties.

4. The Essential Commodities Act, 1955: The Act aims at controlling production, supply and distribution of essential commodities, checking inflationary trend in their prices and ensuring equal distribution of essential commodities. The Act also provides for action against anti-social activities of profiteers, hoarders and black-marketers.

5. The Agricultural Produce (Grading and Marking) Act, 1937: The Act prescribes grade standards for agricultural commodities and live-stock products. The Act stipulates the conditions which govern the use of standards and lays down the procedure for grading, marking and packing of agricultural produce. The quality mark provided under the Act is known as AGMARK, an acronym for Agricultural Marketing.

6. The Prevention of Food Adulteration Act, 1954: The Act aims to check adulteration of food articles and ensure their purity so as to maintain public health.

7. The Standards of Weights and Measures Act, 1976: The provisions of this Act are applicable in case of those goods which are sold or distributed by weight, measure or number. It provides protection to consumers against the malpractice of under-weight or under-measure.

8. The Trade Marks Act, 1999: This Act has repealed and replaced the Trade and Merchandise Marks Act, 1958. The Act prevents the use of fraudulent marks on products and thus, provides protection to the consumers against such products.

9. The Competition Act, 2002: This Act has repealed and replaced the Monopolies and Restrictive Trade Practices Act, 1969. The Act provides protection to the consumers in case of practices adopted by business firms which hamper competition in the market.

10. The Bureau of Indian Standards Act, 1986: The Bureau of Indian Standards has been set up under the Act. The Bureau has two major activities: formulation of quality standards for goods and their certification through the BIS certification scheme. Manufacturers are permitted to use the ISI mark on their products only after ensuring that the goods conform to the prescribed quality standards. The Bureau has also setup a grievance cell where consumers can make a complaint about the quality of products carrying the ISI mark.

The most important of these regulations is the Consumer Protection Act which provides for six consumer rights and helps consumers in getting their grievances redressed for any shortcoming in the goods purchased or services availed.

The Consumer Protection Act, 1986

The Consumer Protection Act (CPA) seeks to protect and promote the consumers' interest through speedy and inexpensive redressal of their grievances.

The scope of the Act is very wide. It is applicable to all types of undertakings, big and small, whether in the private or public sector, or in the co-operative sector, whether a manufacturer or a trader, and whether supplying goods or providing services.

The Act confers certain rights to consumers with a view to empowering them and to protect their interests.

CONSUMER RIGHTS

The Consumer Protection Act provides for six rights of consumers. The consumer protection councils set up under the Act are intended to promote and protect the various rights of consumers. These rights include the following:

1. Right to Safety: The consumer has a right to be protected against goods and services which are hazardous to life and health. For instance, electrical appliances which are manufactured with substandard products or do not conform to the safety norms might cause serious injury. Thus, consumers are educated that they should use electrical appliances which are ISI marked as this would be an assurance of such products meeting quality specifications.

2. Right to be Informed: The consumer has a right to have complete information about the product he intends to buy including its ingredients, date of manufacture, price, quantity, directions for use, etc. It is because of this reason that the legal framework in India requires the manufactures to provide such information on the package and label of the product.

3. Right to Choose: The consumer has the freedom to choose from a variety of products at competitive prices. This implies that the marketers should offer a wide variety of products in terms of quality, brand, prices, size, etc. and allow the consumer to make a choice from amongst these.

4. Right to be Heard: The consumer has a right to file a complaint and to be heard in case of dissatisfaction with a good or a service. It is because of this reason that many enlightened business firms have set up their own consumer service and grievance cells. Many consumer organisations are also working towards this direction and helping consumers in redressal of their grievances.

5. Right to seek Redressal: The consumer has a right to get relief in case the product or service falls short of his expectations. The Consumer Protection Act provides a number of reliefs to the consumers including replacement of the product, removal of defect in the product, compensation paid for any loss or injury suffered by the consumer, etc.

6. Right to Consumer Education: The consumer has a right to acquire knowledge and to be a well informed consumer throughout life. He should be aware about his rights and the reliefs available to him in case of a product or service falling short of his expectations. Many consumer organisations and some enlightened businesses are taking an active part in educating consumers in this respect.

The Consumer Protection Act by conferring these rights on the consumers empowers them to fight against any unscrupulous, exploitative and unfair trade practices adopted by sellers. The Box on East Delhi eatery shows how a restaurant owner was fined for overpricing bottled water.

Eatery fined for Overpricing Bottled Water

A restaurant owner in east Delhi has been directed to pay a fine of Rs. 5,000 to a customer who was asked to shell out Rs. 34 for a water bottle which had a maximum retail price (MRP) of Rs.12. The fine comes at a time when consumer courts are turning the heat on shop-owners who overcharge. In a recent landmark decision, the state consumer commission had slapped a fine of Rs. 50,000 on a cineplex for similar malpractice. Goel was awarded the compensation by east district consumer forum president and members directing Zaika Bazaar, Karkardooma Complex, to compensate Goel for overcharging. The Forum said: "The present complaint is covered by the judgment of the state consumer commision in case of Nirulas vs Ankit Jain in which it said no trader or service provider can charge more price than an item's MRP printed on the packed item, if delivered packed". Ordering the restaurant owner to discontinue the malpractice, the forum said charging higher amount than MRP, if delivered in packed form, was against the law of the land. Goel had bought a bottle of Aquafina water from the restaurant in November last year and was asked to pay Rs.34 for it, including a VAT of Rs. 4, when the bottle had a MRP of Rs.12 printed on it.

Source: www.corecentre.org

Consumer rights, by themselves, cannot be effective in achieving the objective of consumer protection. Consumer protection can, in effect, be achieved only when the consumers also understand their responsibilities.

Consumer Responsibilities

A consumer should keep in mind the following responsibilities while purchasing, using and consuming goods and services.

(i) Be aware about various goods and services available in the market so that an intelligent and wise choice can be made.

(ii) Buy only standardised goods as they provide quality assurance. Thus, look for ISI mark on electrical goods, FPO mark on food products, Hallmark on jewelry etc.

(iii) Learn about the risks associated with products and services, follow manufacturer's instructions and use the products safely.

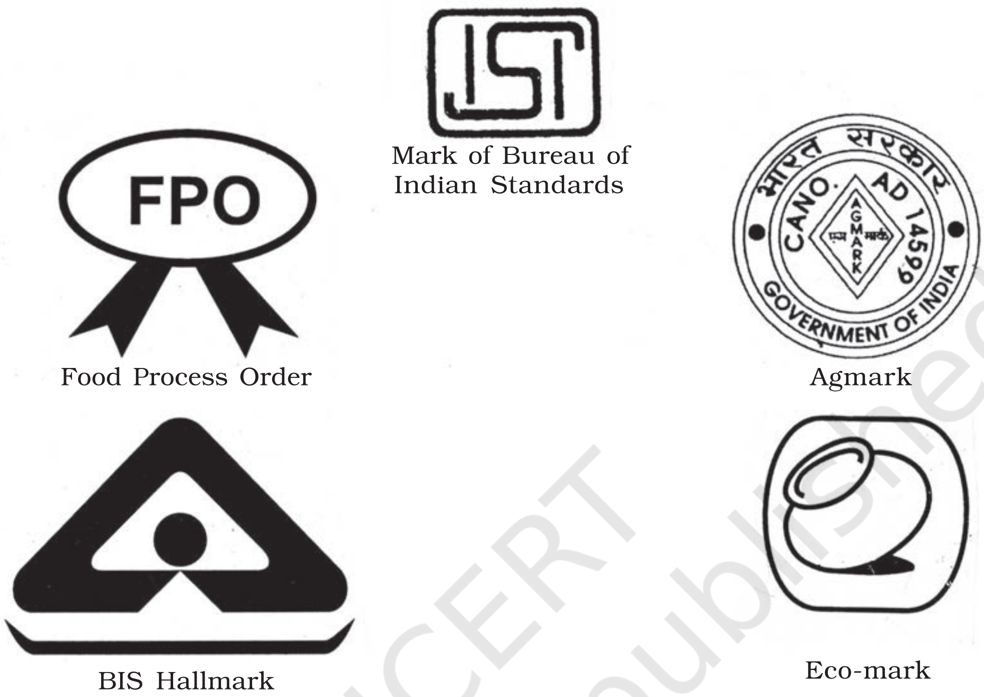
(iv) Read labels carefully so as to have information about prices, net weight, manufacturing and expiry dates, etc.

(v) Assert yourself to ensure that you get a fair deal.

(vi) Be honest in your dealings. Choose only from legal goods and services and discourage unscrupulous practices like black-marketing, hoarding etc.

(vii) Ask for a cash memo on purchase of goods or services. This would serve as a proof of the purchase made.

(viii) File a complaint in an appropriate consumer forum in case of a



Marks indicating quality in different products

shortcoming in the quality of goods purchased or services availed. Do not fail to take an action even when the amount involved is small.

(ix) Form consumer societies which would play an active part in educating consumers and safeguarding their interests.

(x) Respect the environment. Avoid waste, littering and contributing to pollution.

A consumers' awareness about his rights and responsibilities is just one of the ways in which the objective of consumer protection can be achieved. There are other ways in which this objective may be achieved.

Ways and Means of Consumer Protection

There are various ways in which the objective of consumer protection can be achieved.

1. Self Regulation by Business: Enlightened business firms realise that it is in their long-term interest to serve the customers well. Socially responsible firms follow ethical standards and practices in dealing with their customers. Many firms have set up their customer service and grievance cells to redress the problems and grievances of their consumers.

2. Business Associations: The associations of trade, commerce and business like Federation of Indian Chambers of Commerce of India (FICCI) and Confederation of Indian Industries (CII) have laid down their code of conduct which lay down for their members the guidelines in their dealings with the customers.

3. Consumer Awareness: A consumer, who is well informed about his rights and the reliefs available to him, would be in a position to raise his voice against any unfair trade practices or unscrupulous exploitation. In addition to this, an understanding of his responsibilities would also enable a consumer to safeguard his interests.

4. Consumer Organisations: Consumer organisations play an important role in educating consumers about their rights and providing protection to them. These organisations can force business firms to avoid malpractices and exploitation of consumers.

5. Government: The government can protect the interests of the consumers by enacting various legislations. The legal framework in India encompasses various legislations which provide protection to consumers. The most important of these regulations is the Consumer Protection Act, 1986. The

Consumer Awareness

Act provides for a three-tier machinery at the district, state and national levels for redressal of consumer grievances. The redressal mechanism under this three-tier machinery has been explained hereunder.

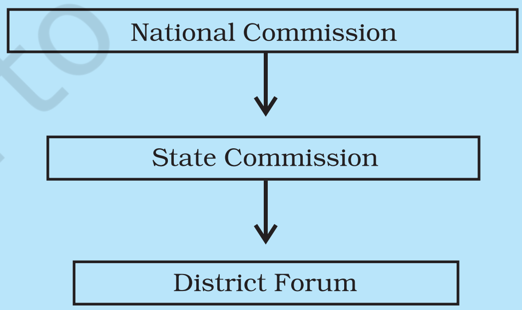
Redressal Agencies Under the Consumer Protection Act

For the redressal of consumer grievances, the Consumer Protection Act provides for setting up of a three-tier enforcement machinery at the District, State, and the National levels, known as the District Consumer Dispute Redressal Forum, State Consumer Disputes Redressal Commission, and the National Consumer Disputes Redressal Commission. They are briefly referred to as the 'District Forum', 'State Commission', and the 'National Commission', respectively. While the National Commission is set up by the Central Government, the State Commissions and the District Forums are set up, in each State and District, respectively, by the State Government concerned. The Figure on redressal agencies shows the hierarchical structure of this three-tire machinery.

Before studying the set-up and functioning of these redressal agencies let see how the Consumer Protection Act defines a consumer and who can file a complaint under the Consumer Protection Act.

Consumer: A 'consumer' is generally understood as a person who uses or consumes goods or avails of any service. Under the Consumer Protection Act, a consumer is defined as:

(a) Any person who buys any goods for a consideration, which has been paid or promised, or partly paid and partly promised, or under any scheme of deferred payment. It includes any user of such goods, when such use is made with the approval of the buyer, but does not include a person who obtains goods for re-sale or any commercial purpose.



Redressal Agencies under the Consumer Protection Act

(b) Any person who hires or avails of any service, for a consideration which has been paid or promised, or partly paid and partly promised, or under any system of deferred payment. It includes any beneficiary of services when such services are availed of with the approval of the person concerned, but does not include a person who avails of such services for any commercial purpose.

Who can file a complaint?: A complaint before the appropriate consumer forum can be made by:

(i) Any consumer;

(ii) Any registered consumers' association;

(iii) The Central Government or any State Government;

(iv) One or more consumers, on behalf of numerous consumers having the same interest; and

(v) A legal heir or representative of a deceased consumer.

Let us now see how the consumer grievances are redressed by the three-tire machinery under the Consumer Protection Act.

1. District Forum: The District Forum consists of a President and two other members, one of whom should be a woman. They all are appointed by the State Government concerned. A complaint can to be made to the appropriate District Forum when the value of the goods or services in question, along with the compensation claimed, does not exceed Rs. 20 lakhs. On receiving the complaint, the District Forum shall refer the complaint to the party against whom the complaint is filed. If required, the goods or a sample thereof, shall be sent for testing in a laboratory. The District Forum shall pass an order after considering the test report from the laboratory and hearing to the party against whom the complaint is filed. In case the aggrieved party is not satisfied with the order of the District Forum, he can appeal before the State Commission within 30 days of the passing of the order.

2. State Commission: Each State Commission consists of a President and not less than two other members, one of whom should be a woman. They are appointed by the State Government concerned. A complaint can to be made to the appropriate State Commission when the value of the goods or services in question, along with the compensation claimed, exceeds Rs. 20 lakhs but does not exceed Rs. 1 crore. The appeals against the orders of a District Forum can also be filed before the State Commission. On receiving the complaint, the State Commission shall refer the complaint to the party against whom the complaint is filed. If required, the goods or a sample thereof, shall be sent for testing in a laboratory. The State Commission shall pass an order after considering the test report from the laboratory and hearing to the party against whom the complaint is filed. In case the aggrieved party is not satisfied with the order of the State Commission, he can appeal before the National Commission within 30 days of the passing of the order.

3. National Commission: The National Commission consists of a President and at least four other members, one of whom should be a woman. They are appointed by the Central Government. A complaint can to be made to the National Commission when the value of the goods or services in question, along with the compensation claimed, exceeds Rs. 1 crore. The appeals against the orders of a State Commission can also be filed before the National Commission. On receiving the complaint, the National Commission shall refer the complaint to the party against whom the complaint is filed. If required, the goods or a sample thereof, shall be sent for testing in a laboratory. The National Commission shall pass an order after considering the test report from the laboratory and hearing to the party against whom the complaint is filed.

An order passed by the National Commission in a matter of its original jurisdiction is appealable before the Supreme Court. This means that only those appeals where the value of goods and services in question, along with the compensation claimed, exceeded Rs. 1 crore and where the aggrieved party was not satisfied with the order of the National Commission, can be taken to the Supreme Court of India. Moreover, in a case decided by the District Forum, the appeal can be filed before the State Commission and, thereafter, the order of the State Commission can be challenged before the National Commission and no further.

Relief Available

If the consumer court is satisfied about the genuineness of the complaint, it can issue one or more of the following directions to the opposite party.

(i) To remove the defect in goods or deficiency in service.

(ii) To replace the defective product with a new one, free from any defect.

(iii) To refund the price paid for the product, or the charges paid for the service.

(iv) To pay a reasonable amount of compensation for any loss or injury suffered by the consumer due to the negligence of the opposite party.

(v) To pay punitive damages in appropriate circumstances.

(vi) To discontinue the unfair/restrictive trade practice and not to repeat it in the future.

(vii) Not to offer hazardous goods for sale.

(viii) To withdraw the hazardous goods from sale.

(ix) To cease manufacture of hazardous goods and to desist from offering hazardous services.

(x) To pay any amount (not less than 5% of the value of the defective goods or deficient services provided), to be credited to the Consumer Welfare Fund or any other organisation/person, to be utilised in the prescribed manner.

Some Decided Cases

Under the Consumer Protection Act, a consumer can file a complaint against the manufacturers or sellers for any defective good supplied to him or any deficient services rendered to him.

In *Jose Philip Mampillil vs. M/s Premier automobiles Ltd. & Anr*, a diesel car purchased by the appellant (consumer) was found defective. The defects in the car were not removed by the defendants (manufacturer and dealer). The Commissioner appointed by the District Forum found a large number of defects in the car. Consequently, the District Forum directed repair of car free of cost and replacement of engine. The order was upheld by the State Commission except for the direction for replacement of engine.

In the case of *Sashikant Krishnaii Dole vs. Shikshan Prasarak Mandali*, the National Commission held that failure to amount basic safeguards in the swimming pool amounts to deficiency in service. A school owned a swimming pool and offered swimming facilities to the public on payment of a fee. The school conducted winter and summer training camps to train boys in swimming and for this purpose engaged a coach. The plaintiffs enrolled their only son for learning swimming under the guidance of the coach. It was alleged that due to the negligence of the coach, the boy drowned and died. The school denied any responsibility on its part. The coach claimed that he had considerable experience in coaching young boys is swimming. When the deceased was found to have been drowned, the coach immediately took him out of the water and removed the water from his stomach and gave him artificial respiration and thereafter took him to a doctor. The doctor advised that the boy be taken to the nearest hospital where the boy died. The State Commission held the school and the coach deficient in rendering service to the deceased. On appeal, the order was upheld by the National Commission.

Adapted from: www.indiainfoline.com

(xi) To issue corrective advertisement to neutralise the effect of a misleading advertisement.

(xii) To pay adequate costs to the appropriate party.

Brings out some decided cases where a complaint was filed in a consumer court for defective goods and deficient services.

Role of Consumer Organisations and NGOs

In India, several consumer organisations and non-governmental organisations (NGOs) have been set up for the protection and promotion of consumers' interests. Non-governmental organisations are non-profit organisations which aim at

CERS Wins Case against Railways

In a case filed by Consumer Education and Research Society (CERS), Ahmedabad, and a senior couple, the Consumer Dispute Redressal Forum, Ahmedabad City, has held the Railways responsible for negligence and directed it to pay Rs. 2000 to the couple for its mental agony and Rs. 3000 towards cost.

Mr. Man Mohan Singh and his wife Kamlesh had bought a railway journey-cum-reservation ticket at Ahmedabad for travel from New Delhi to Kanpur Central by the Shatabdi Express on 2 December 2001. The details on the ticket, including the coach number, the date of journey, etc., were illegible. Hence, they were forced to buy another ticket for journey from New Delhi to Kanpur. They applied for a refund for the earlier ticket but, as the Forum noted, they had to suffer much for the purpose. In spite of the couple's giving the Ahmedabad residential address for sending the refund, the Railways sent it to their Delhi address. They approached CERS for help.

CERS filed a complaint against the Railways before the Consumer Dispute Redressal Forum, Ahmedabad City, under Sections 2(1)(g) and 2(1)(o) of the Consumer Protection Act, 1986. CERS claimed that the two senior citizens had to face mental harassment due to the deficiency in service by the Railways. The Railways contended, among other things, that the Forum had no territorial jurisdiction after cancellation of the ticket, the couple were no more consumers in the eye of the law, the complaint was time-barred and the Railway Claim Tribunal was the proper forum to entertain the complaint about refund.

The Forum, however, observed that the couple's difficulties amounted to the Railways' deficiency in service and ordered it to pay Rs. 2000 to the couple for the mental agony suffered by them and Rs. 3000 as cost. The Forum did not decide on the amount of refund, which it said, was "to be exclusively dealt with by the Railway Claim Tribunal".

Source: www.corecentre.org

promoting the welfare of people. They have a constitution of their own and are free from government interference. Consumer organisations and NGOs perform several functions for the protection and promotion of interest of consumers. These include:

(i) Educating the general public about consumer rights by organising training programmes, seminars and workshops.

(ii) Publishing periodicals and other publications to impart knowledge about consumer problems, legal reporting, reliefs available and other matters of interest.

(iii) Carrying out comparative testing of consumer products in accredited laboratories to test relative qualities of competing brands and publishing the test results for the benefit of consumers.

(iv) Encouraging consumers to strongly protest and take an action against unscrupulous, exploitative and unfair trade practices of sellers.

(v) Providing legal assistance to consumers by way of providing aid, legal advice etc. in seeking legal remedy.

(vi) Filing complaints in appropriate consumer courts on behalf of the consumers.

(vii) Taking an initiative in filing cases in consumer courts in the interest of the general public, not for any individual.

Some of the important consumer organisations and NGOs engaged in protecting and promoting consumers' interests include the following.

(i) Consumer Coordination Council, Delhi

(ii) Common Cause, Delhi

(iii) Voluntary Organisation in Interest of Consumer Education (VOICE), Delhi

(iv) Consumer Education and Research Centre (CERC), Ahmedabad

(v) Consumer Protection Council (CPC), Ahmedabad

(vi) Consumer Guidance Society of India (CGSI), Mumbai

(vii) Mumbai Grahak Panchayat, Mumbai

(viii) Karnataka Consumer Service Society, Bangalore

(ix) Consumers' Association, Kolkata

(x) Consumer Unity and Trust Society (CUTS), Jaipur

Key Terms

Consumer Protection	Consumer Rights	Consumer Responsibilities
Redressal of grievance	Grades	Standards

SUMMARY

Importance of Consumer Protection: From the point of consumers, consumer protection is important because consumers are ignorant, unorganised and exploited by sellers. Consumer Protection is also important for a business because (i) It is in the long-term interest of business, (ii) Business uses society's resources, (iii) It is a social responsibility of business, (iv) It has moral justification, (v) It avoids government intervention in the functioning of business.

Legal Protection to Consumers: The Indian legal framework consists of a number of regulations which provide protection to consumers. These include (i) The Consumer Protection Act, 1986, (ii) The Indian Contract Act, 1872, (iii) The Sale of Goods Act, 1930, (iv) The Essential Commodities Act,1955, (v) The

Agricultural Produce (Grading and Marking) Act, 1937, (vi) The Prevention of Food Adulteration Act, 1954, (vii) The Standards of Weights and Measures Act, 1976, (viii) The Trade Marks Act, 1999, (ix) The Competition Act, 2002, (x) The Bureau of Indian Standards Act, 1986.

Consumer Rights: The Consumer Protection Act, 1986, provides for six consumer rights. These are: (i) Right to safety, (ii) Right to be informed, (iii) Right to choose, (iv) Right to be heard, (v) Right to seek redressal, (vi) Right to consumer education.

Consumer Responsibilities: In addition to exercising his rights, a consumer should also keep in mind his responsibilities while purchasing, using and consuming goods and services.

Ways and Means of Consumer Protection: There are various ways in which the objective of consumer protection can be achieved. These Include (i) Self regulation by business, (ii) Business associations, (iii) Consumer awareness, (iv) Consumer organisations, (v) Government.

Redressal Agencies under the Consumer Protection Act: The Consumer Protection Act provides for setting up of a three-tier enforcement machinery at the District, State, and the National levels. They are referred to as the 'District Forum', 'State Commission', and the 'National Commission'. There are various reliefs available to a consumer under the Act. The appropriate consumer court may pass an order for removal of defect in goods, replace a defective product, refund the price of the product, pay compensation for the loss suffered, etc.

Consumer Organisations and NGOs: In India, several consumer organisations and non-governmental organisations (NGOs) are playing an active role in protection and promotion of consumers' interests.

EXERCISES

True or False

State whether the following statements are true or false.

(i) Consumer protection has a moral justification for business.

(ii) In addition to rights, a consumer also has some responsibilities.

(iii) A complaint can to be made to a District Forum when the value of the goods or services in question, along with the compensation claimed, exceeds Rs. 20 lakhs.

(iv) The Consumer Protection Act provides for six consumer rights.

(v) ISI is the quality certification mark used in case of food products.

(vi) Under the Consumer Protection Act, a complaint can be filed by a consumer for a defective good and also for deficiency in service.

Short answer questions

(i) Explain the importance of consumer protection from the point of view of a business.

(ii) Enumerate the various Acts passed by the Government of India which help in protection of consumers' interests.

(iii) What are the responsibilities of a consumer?

(iv) Who can file a complaint in a consumer court?

(v) What kind of cases can be filed in a State Commission?

(vi) Explain the role of consumer organisations and NGOs in protecting and promoting consumers' interests.

Long answer questions

(i) Explain the rights and responsibilities of a consumer.

(ii) What are various ways in which the objective of consumer protection can be achieved? Explain the role of consumer organisations and NGOs in this regard.

(iii) Explain the redressal mechanism available to consumers under the Consumer Protection Act, 1986.

Application based questions

(i) Visit a consumer organisation in your town. List down the various functions performed by it.

(ii) Collect some newspaper cuttings of some consumer cases and the rulings given therein.

Case Problem

Now, filing complaint is just a click away. Filing a complaint in a consumer court's going to get a lot easier by the end of this year, virtually. No matter which part of the country you're in, it's going to happen at the click of a mouse.

The project, called Confonet (Computerisation and Computer Networking of Consumer Fora), is being executed on a turnkey basis by the National Informatics Centre (NIC).

"Online registration of complaints, the government hopes, will promote e-governance, transparency, efficiency and streamlining of consumer fora," said an official in the consumer affairs ministry. Of Rs 48.64 crore set aside for the project, the government has released Rs 30.56 crore so far, the official added.

"Besides software development and testing, networking and project implementation, integration and site preparation, it will include purchase of hardware for all the 600 district fora, 35 state commissions and the National Commission," the official said.

At present, computer systems and system software have been delivered to 25 state commissions and 300 district fora — never mind the fact that it's sometimes a long wait before the hardware is finally unpacked and set up in some of the districts. Meanwhile, training of staff, sometimes in the classroom and sometimes through e-learning sessions, are in full swing.

"But just setting up an online complaint filing system won't ensure a strong consumer protection movement in the country — for that we're working on GenNext and the best way to do that is to go to schools," the official said.

The government is, therefore, involving school children to form consumer clubs so as to involve them in various consumer welfare activities.

Part of the funding for running the club is to come from various state governments, with an equally matching grant from the Centre. However, a number of state governments are yet to sanction the fund — some of these include Uttar Pradesh, Madhya Pradesh and Kerala.

Source: www.economictimes.indiatimes.com

Questions

1. What new measures is the ministry of consumer affairs taking to make filing of complaint easy?
2. What role can you, as a student, play to contribute to the cause of consumer protection?
3. What scenario of consumer protection do you foresee when the measures proposed in the above news report are implemented?

   (Teachers are advised to help students to study judgements of various consumer forums including National Consumer Disputes Redressal Commission at www.ncdrc.nic.in. This initiative will help the pupils to understand the role of consumer protection in India better. Various published material can also be used. Consumer clubs in schools can also help the students in this regard.)

CHAPTER 13

ENTREPRENEURSHIP DEVELOPMENT

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- state the meaning of the terms, 'entrepreneur,' 'entrepreneurship' and 'enterprise';
- distinguish between entrepreneurship and management and discuss the characteristics of entrepreneurship;
- explain the need for entrepreneurship;
- describe the roles and functions of the entrepreneurs;
- identify the entrepreneurial competencies;
- explain and follow the process of entrepreneurship development; and
- identify the values, attitudes and motivation for a plunge in entrepreneurship.

SEEDS OF VIRCHOW

Until 1981 Narayan Reddy, M.Sc. Organic Chemistry, had been working for a pharmaceutical company where he had developed a molecule. He was contemplating commercial utilisation of that molecule by setting up a small-scale unit – much smaller than what he actually started. Actually, he met two medicos, who had just returned from a Gulf country and were looking for some productive avenue for investment of their savings (remember the Gulf crisis?), Reddy's idea appealed to them. Thus, the willing entrepreneurs met– where there is a will there is a way– and the seeds for the venture were sown. After a detailed study of the technical, economic, commercial and financial feasibility of the idea of manufacturing a bulk drug from the molecule, 'Virchow Laboratories' was started in 1982 as a SSI with an initial investment of Rs. 28 lakhs – Rs. 8 lakh in the form of equal contribution by the three promoters and Rs. 20 lakh funding from the Andhra Pradesh State Finance Corporation (APSFC). Project implementation was even more challenging as he set out to acquire land, construct factory, purchase equipment, negotiate with suppliers, potential customers and obtain environmental, drug control and other clearances. Initially, it was he who acted as the pivot of the enterprise wheel. In the course of time, a strong managerial team was put in place and thanks to persistent emphasis on good management practices, Virchow emerged as the world's largest and the best producer of the basic drug from the chosen molecule. In fact, web search on 'Virchow Laboratories' takes you to the home page saying "Welcome to Virchow Group of Companies", the group comprising 4 companies with Virchow Laboratories being the flagship company.

INTRODUCTION

Entrepreneurship is the process of setting up one's own business as distinct from pursuing any other economic activity, be it employment or practising some profession. The person who set-up his business is called an entrepreneur. The output of the process, that is, the business unit is called an enterprise. You may invoke 'subject-verb-object (SVO)' relationship in English grammar to clearly understand these terms. (See Figure on SVO Analogy)

It is interesting to note that entrepreneurship besides providing self-employment to the entrepreneur is responsible to a great extent for creation and expansion of opportunities for the other two economic activities, that is, employment and profession. (Can you think why and how?) Further, each business gives rise to other businesses– the suppliers of raw materials and components, service providers (be it transport, courier, telecom, distributor middlemen and advertising firms, accounting firms and advocates etc. And, in the process, entrepreneurship becomes crucial for overall economic development of a nation.

Given its important role in the overall scheme of economic development, it is interesting to note that not many persons opt for a career in entrepreneurship. Traditionally, it was believed that entrepreneurs are born.

No society can wait for the chance of 'birth' of entrepreneurs to pursue its developmental plans. In fact, plans for economic development would bear little fruit unless entrepreneurship development is regarded as a deliberate process of making people aware of entrepreneurship as a career at an early age and creating situations where they may actually make a choice to become entrepreneurs.

When you make this choice, you become a job-provider rather than a job-seeker, besides enjoying a host of other financial and psychological rewards. Taking to entrepreneurship is surely more a matter of aspiring to become an entrepreneur rather as being born as one.

Entrepreneur	→	Entrepreneurship	→	Enterprise
The Person/The Actor **S**ubject		The Process/The Act **V**erb		The Outcome **O**bject

SVO Analogy

Entrepreneurship: All in your Hands

The Concept of Entrepreneurship

You are aware that entrepreneurship is regarded as one of the four major factors of production, the other three being land, labour and capital. However, it should surprise you that as regards its French origin, the term 'entrepreneurship' (derived from the verb 'entreprende' meaning 'to undertake') pertained not to economics but to undertaking of military expeditions. So is true of many terms in management such as strategy (a course of action to beat the competition, the 'enemy') and logistics (movement of men and machines for timely availability), etc. Historically, as wars are followed by economic reconstruction, it should be no surprise that military concepts are used in economics and management. It may be pointed out that whereas the wars are rare and far between, in today's competitive world, entrepreneurs wage wars everyday. There is a tremendous pressure to continually develop new products, explore new markets, update technology and devise innovative ways of marketing and so on.

The term 'entrepreneur' was first introduced in economics by the early 18th century French economist Richard Cantillon. In his writings, he formally defined the entrepreneur as the "agent who buys means of production at certain prices in order to sell the produce at uncertain prices in the future". Since then a perusal of the usage of the term in economics shows that entrepreneurship implies risk/uncertainty bearing; coordination of productive resources; introduction of innovations; and the provision of capital.

We would like to define entrepreneurship as a systematic, purposeful and creative activity of identifying a need, mobilising resources and organising production with a view to delivering value to the customers, returns for the investors and profits for the self in accordance with the risks and uncertainties associated with business. This definition points to certain characteristics of entrepreneurship that we turn our attention to.

Characteristics of Entrepreneurship

In the SVO formulation of the concepts of entrepreneur, entrepreneurship and enterprise, we saw that entrepreneurship is about the process of setting up a business. One cannot help but marvel at the beauty of the process: how does one first of all decide to choose own business as a career; how does one sense a market opportunity; how does one muster up courage to embark upon it, and mobilise the requisite resources, etc.; so much so that recourse to entrepreneurship, in common parlance, is considered as an exclusive preserve of a few gifted individuals. In the following paragraphs, our effort would be to establish entrepreneurship as a career that you should aspire for. Remember, resources may be limited, aspiration need not be. So, you can aspire for something greater, bigger than your present status and resources. And start today. Remember, aspiration means desire *multiplied by* action.

1. Systematic Activity: Entrepreneurship is not a mysterious gift or

Nurturing Success

charm and something that happens by chance! It is a systematic, step-by-step and purposeful activity. It has certain temperamental, skill and other knowledge and competency requirements that can be acquired, learnt and developed, both by formal educational and vocational training as well as by observation and work experience. Such an understanding of the process of entrepreneurship is crucial for dispelling the myth that entrepreneurs are born rather than made.

2. Lawful and Purposeful Activity: The object of entrepreneurship is lawful business. It is important to take note of this as one may try to legitimise unlawful actions as entrepreneurship on the grounds that just as entrepreneurship entails risk, so does illicit businesses. Purpose of entrepreneurship is creation of value for personal profit and social gain.

3. Innovation: From the point of view of the firm, innovation may be cost saving or revenue-enhancing. If it does both it is more than welcome. Even if it does none, it is still welcome as innovation must become a habit!

Entrepreneurship is creative in the sense that it involves creation of value. You must appreciate that in the absence of entrepreneurship 'matter' does not become a "resource." By combining the various factors of production, entrepreneurs produce goods and services that meet the needs and wants of the society. Every entrepreneurial act results in income and wealth generation. Even when innovations destroy the existing industries, for example, zerox machines destroyed carbon paper industry, mobile telephony threatens landline/basic telephony, net gains accruing to the economy lend such entrepreneurial actions as commendable as the acts of creative destruction.

Entrepreneurship is creative also in the sense that it involves innovation- introduction of new products, discovery of new markets and sources of supply of inputs, technological breakthroughs as well as introduction of newer organisational forms for doing things better, cheaper, faster and, in the present context, in a manner that causes the least harm to the ecology/environment. It is possible that entrepreneurs in developing countries may not be pioneering/innovative in introducing path-breaking, radical innovations. They may be the first or second adopters of technologies developed elsewhere. That does not make their achievement small. For imitating technologies from developed world to the indigenous setting is quite challenging. A lady entrepreneur wanting to introduce thermal pads for industrial heating faced tremendous reluctance form the owners of chemical and sugar mills despite the established superiority of her products over the conventional heating of the vessels by burning of wood/coke or using LPG. Moreover, there is no need to suffer from "it was not invented here" complex– there is no need to reinvent the wheel. The global electronics major, Sony did not invent the transistor! It used the transistor to build entertainment products that are world leaders.

4. Organisation of Production: Production, implying creation of form, place, time personal utility, requires the combined utilisation of diverse factors of production, land, labour, capital and technology. Entrepreneur, in response to a perceived business opportunity mobilises these resources into a productive enterprise or firm. It may be pointed out that the entrepreneur may not be possessing any of these resources; he may just have the 'idea' that he promotes among the resource providers. In an economy with a well-developed financial system, he has to convince just the funding institutions and with the capital so arranged he may enter into contracts of supply of equipment, materials, utilities (such as water and electricity) and technology. What lies at the core of organisation of production is the knowledge about availability and location of the resources as well as the optimum way to combine them. An entrepreneur needs negotiation skills to raise these in the best interests of the enterprise. Organisation of production also involves product development and development of the market for the product. Besides, entrepreneur may be required to develop even the sources of supply of requisite inputs. For example, whether it is a matter of putting together an automobile manufacturing unit or manufacture of burger/pizza, besides cultivating a market and developing products to suit its tastes and preferences, there would be a need to develop a pool of suppliers of the diverse components or elements that go into their manufacture.

5. Risk-taking: As the entrepreneur contracts for an assured supply of the various inputs for his project, he incurs the risk of paying them off whether or not the venture succeeds. Thus, landowner gets the contracted rent, capital providers gets the contracted interest, and the workforce gets the contracted wages and salaries. However, there is no assurance of profit to the entrepreneur.

It may be pointed out that the possibility of absolute ruin may be rare as the entrepreneur does everything within his control to de-risk the business. For example he may enter into prior contract with the customers of his production. So much so that he may just be contract manufacturer or marketer of someone else's products! What is generally implied by risk-taking is that *realised profit may be less than the expected profit*.

It is generally believed that entrepreneurs take high risks. Yes, individuals opting for a career in entrepreneurship take a bigger risk that involved in a career in employment or practice of a profession as there is no "assured" payoff. (See Box above) In practice, for example, when a person quits a job to start on his own, he tries to calculate whether he or she would be able to earn the same level of income or not. To an observer, the risk of quitting a well-entrenched and promising career seems a "high" risk,

Understanding Entrepreneurial Returns and Risks

Entrepreneurial returns are based on a mathematical expectation, E (R_i) where the subscript 'i' shows that there are a number of possible rates of return from a business decision, say, 20%, 18%, 17% and 15%. Actually, there may be quite a large distribution of alternative returns from an investment decision, we have taken just 4 observations to keep it simple. Supposing all these returns are equally likely, then E (R_i) would be the simple average of these returns. That is, E (R_i) = ϕ = 20+18+17+15/4= 17.5%. In other words, the expected returns from the entrepreneurial decision in this case are 17.5 %. Risk can be measured in terms of a measure of variation around this expectation, more precisely it is the standard deviation of the distribution of returns or $ó_{Ri}$. In this case it works out be 1.8 %. In other words, actual or realised returns may deviate from expected returns to the extent of 1.8%. Clearly, higher the value of standard deviation, larger the risk. It is often said that higher the risk greater the returns. What this means is as under:

(a) for a given risk, a rational person would prefer a higher than or equal to the expected returns.
(b) for a given return, a rational person would prefer a lower risk.
(c) should the risk increase, there should be at least a proportional increase in returns.
(d) because the risk runs either ways, that is, realised returns may be more or less that the expected returns, entrepreneurs who are incorrigibly optimistic, tend to believe that variation would only be one-sided, that is, on the higher side.

but what the person has taken is a calculated risk. The situation is similarly to a motorcyclist in the 'ring of death' or a trapeze artist in circus. While the spectators are in the awe of the high-risk, the artists have taken a calculated risk given their training, skills, and of course, confidence and daring. It is said that the entrepreneurs thrive on circumstances where odds favouring and against success area even, that is 50:50 situations. They are so sure of their capabilities that they convert 50% chances into 100% success. They avoid situations with higher risks as they hate failure as anyone would do; they dislike lower risk situations as business ceases to be a game/fun! Risk as such more than a financial stake, becomes a matter of personal stake, where less than expected performance causes displeasure and distress.

The characteristics of entrepreneurship discussed as above apply in diverse contexts, so does the usage of the term, viz., Agricultural/Rural Entrepreneurship, Industrial entrepreneurship, Technopreneurship, Netpreneurship, Green/Environmental or Ecopreneurship, Intra-corporate/firm or Intrapreneusrhip and Social entrepreneurship. In fact, entrepreneurship has come to be regarded as a 'type of behaviours', whereby one, (i) rather than becoming a part of the problem, proactively tries to solve it; (ii) uses personal creativity and intellect to develop innovative solutions; (iii) thinks beyond resources presently controlled in exploiting the emerging opportunities or attending to the impending problems; (iv) has the conviction to convince others of one's ideas and seek their commitment towards the project; and (v) has the courage of heart to withstand adversities, persist despite setbacks and be generally optimistic.

Relationship between Entrepreneurship and Management

Entrepreneurship is about business start-ups and renewals. That is, it appears at the time of starting a new business, disappears for some time in the course of stabilising the venture as an on-going business and reappears in case there is a need for introducing changes in product, market, technology, structure and so on. In fact, it is said that everyone is an entrepreneur when he actually 'carries out new combinations,' and loses that character as soon as he has built up his business, when he settles down to running it as other people run their businesses. In developed countries, the distinction between the entrepreneurial focus on start-ups and managerial focus on routine is so sharp that it is argued that once the project has reached a level of maturity, the entrepreneurs must move out and the managers must come in.

In developing countries, however, the concept of owner-manager seems more apt for entrepreneurship as the entrepreneur remains attached even to the day-to-day operations of the venture. In fact, their lacking in managerial skills is often forwarded as the cause of business failures. Just as managers are expected to play entrepreneurial roles in the times of need, likewise the entrepreneurs must also demonstrate managerial abilities for the success of their ventures. Irrespective of whether the entrepreneurs pave way for the managers or they themselves assume the managerial responsibilities, it is possible to distinguish between the terms entrepreneurship and management. (See the table on next page)

Need for Entrepreneurship

Every country, whether developed or developing, needs entrepreneurs. Whereas, a developing country needs entrepreneurs to initiate the process of development, the developed one needs entrepreneurship to sustain it. In the present Indian context, where on the one hand, employment opportunities in public sector and large-scale sector are shrinking, and on the other, vast opportunities arising from globalisation are waiting to be exploited; entrepreneurship can really take India to the heights of becoming a super economic power. (See the Box entitled 'India Needs Entrepreneurs')

Studies by Global Entrepreneurship Monitor, a research programem involving annual assessment of the

Differences between Entrepreneurship and Management

S. No.	***Basis of Differentiation***	***Entrepreneurship***	***Management***
1.	Focus	Business start-up	Ongoing operations of an existing business
2.	Resource orientation	The entrepreneur does not feel constrained by resource. Entrepreneur mobilises the resources	A manager is constrained by the resources at his disposal
3.	Approach to the task	Informal	Formal
4.	Primary motivation	Achievement	Power
5.	Status vis-à-vis the enterprise	Owner	Employee
6.	Primary economic reward	Profit	Salary
7.	Innovation orientation	Challenges the *status quo*, that is, the existing	Maintains the *status quo*
8.	Risk orientation	Risk-taker	Risk-averse
9.	Approach to decision-making	Driven by inductive logic and personal courage and determination	Driven by deductive logic and research
10.	Scale of operations	Small business	Large business
11.	Primary skill requirement	Opportunity spotting, initiative, resource negotiation	Organising, systems design and operating procedures, people management
12.	Specialisation orientation	Generalist has to know and do all the trades by himself	Specialist

India needs Entrepreneurs

It needs them for two reasons: to capitalise on new opportunities and to create wealth and new jobs. A McKinsey and Company–Nasscom report estimates that India needs at least 8,000 new businesses to achieve its target of building a $ 87 billion IT sector by 2008. Similarly, in the next 10 years, 110-130 million Indian citizens will be searching for jobs, including 80-100 million looking for their first jobs; that's seven times Australia's population. This does not include disguised unemployment of over 50% among the 230 million employed in rural India. Since traditional large employers – including the government and the old economy players – may find it difficult to sustain this level of employment in the future, it is entrepreneurs who will create these new jobs and opportunities.

Source: http://www.uwcsea.edu. (First published in India Today, February 2001)

national level of entrepreneurial activity across a number of countries (visit, www.gemconsortium.org) show that differences in the levels of entrepreneurial activity account for the differences in the level of economic growth to the extent of as much as 33%.

What is that the entrepreneurs do to affect economic development? This leads us to a discussion of the functions of the entrepreneurs in relation to economic development. As the enterprise is the object of their endeavour, it is also necessary that we examine their functions in relation to the enterprise as well.

Thus, the need for entrepreneurship arises from the functions the entrepreneurs perform in relation to the process of economic development and in relation to the business enterprise.

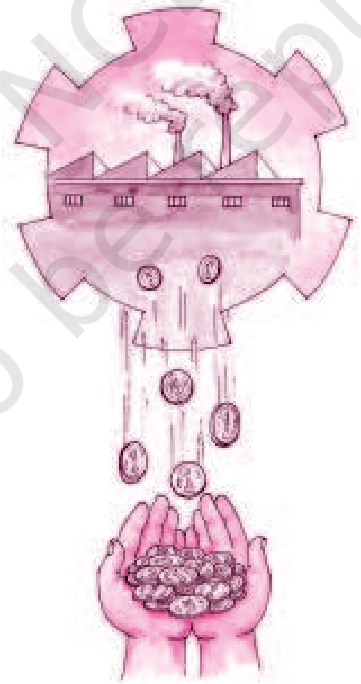
Functions of Entrepreneurs in Relation to Economic Development

You are aware that entrepreneurs "organise" the production process. In the absence this function, all other resources, namely land, labour and capital would remain idle. They may not be inventing/discovering the products, their role in commercial exploitation of the advancements in science and technology via organisation of the productive apparatus makes the other resources productive and useful. So much so that it is said that in the absence of entrepreneurial intervention, every plant would remain a weed and every mineral would remain a rock.

1. Contribution to GDP: Increase in the Gross Domestic Product or GDP is the most common definition of economic development. You are aware that income is generated in the process of production. So, entrepreneurs generate income via organisation of production be it agriculture, manufacturing or services.

You are also aware that income generated is distributed among the factors of production where land gets rent, labour gets wages and salaries, capital gets interest and the residual income accrues to the entrepreneur in the form of profits. As rent and interest accrue to those few who have land and capital respectively whereas larger masses are destined to earn their incomes via wage employment, the biggest contribution of the entrepreneurship lies in capital formation and generation of employment. This is what we turn our attention to.

2. Capital Formation: The entrepreneurial decision, in effect, is an investment decision that augments the productive capacity of the economy and hence results in capital formation. In fact, GDP and capital formation are related to each other via Capital Output Ratio (COR); more precisely Incremental Capital Output Ratio (ICOR) that measures the percentage increase in capital formation required obtaining a percentage increase in GDP. So, if a country desires to grow @ 10.0 % p.a. and its ICOR is 2.6, then it must ensure capital formation @ 26.0% p.a. Entrepreneurs, by investing their own savings and informally mobilising the savings of their friends and relatives contribute to the process of capital formation. These informal funding supplements the funds made available by the formal means of raising resources from banks, financial institutions and capital markets.



Capital Formation

3. Generation of Employment: Every new business is a source of employment to people with different abilities, skills and qualifications. As such entrepreneurship becomes a source of livelihood to those who do neither have capital to earn interest on nor have the land to earn rent . In fact, what they earn is not only a livelihood or means of sustenance but also a lifestyle for themselves and their families as well as personal job satisfaction. As such entrepreneurs touch the lives of many, directly as well as indirectly.

4. Generation of Business Opportunities for Others: Every new business creates opportunities for the suppliers of inputs (this is referred to as backward linkages) and the marketers of the output (what is referred to as forward linkages). As a pen manufacturer you would create opportunities for refill manufacturers as well as wholesalers and retailers of stationery products. These immediate linkages induce further linkages. For example greater opportunities for refill manufacturers would mean expansion of business for ink manufacturers. In general, there are greater opportunities for transporters, advertisers, and, so on. So, via a chain-reaction, entrepreneurship provides a spur to the level of economic activity.

5. Improvement in Economic Efficiency: You are aware that efficiency means to have greater output from the same input. Entrepreneurs improve economic efficiency by,

a. Improving processes, reducing wastes, increasing yield ,and,
b. Bringing about technical progress, that is, by altering labour-capital ratios. You are aware that if labour is provided with good implements (capital), its productivity increases.

6. Increasing the Spectrum and Scope of Economic Activities: Development does not merely mean 'more' and 'better' of the existing, it also and more crucially means diversification of economic activities– across the geographic, sectoral and technological scope.

You are aware that underdeveloped countries are caught in the vicious cycles on the demand as well as supply side. Entrepreneurs penetrate into and break these cycles, for example, by organising and orienting domestic production for exports. Thus, production (and thereby generation of income) is not constrained by the inadequacy of domestic demand. (Demand-side Vicious Cycle). In today's context, you are aware that India is poised to become a manufacturing hub for the global markets for diverse products.

Economic development is also constrained by the supply-side pressures resulting into absence of capacity to meet the demand whether domestic or overseas. Entrepreneurs mobilise local and even overseas resources to augment the productive capacity of a country. Indian Multinational Giants is fast becoming a reality.

Entrepreneurs lead the process of economic development via bringing

Small-Scale Entrepreneurship among Marginalised Groups in India

Marginalised Groups	Proportional Representation in Overall Entrepreneurship (%)
Women Entrepreneurs	8
Scheduled Caste (SC) Entrepreneurs	8
Scheduled Tribes (ST) Entrepreneurs	4
Entrepreneurs from the Other Backward Classes (OBC)	49

Source: Third Census of Small Scale Industries in India, Ministry of Small Scale Industries, Government of India

about sectoral change. You must be aware that as the economies grow, percentage of GDP originating from agriculture decreases and that originating in industry and services sectors goes up. Entrepreneurs through their decisions to divest from the stale sectors and invest in green-field sectors bring about a virtual transformation of the economy from 'underdeveloped' to an 'emerging' and 'developed' status.

7. Impact on Local Communities: Entrepreneurship, in its natural habitat, that is, small business is a great leveler. You may see from table on marginalised groups. That small-scale entrepre-neurship enables such marginalised groups as women, SC, ST and OBC to pursue their economic dreams. As there are no entry barriers in terms of educational qualifications, entrepreneurship is an even more attractive career option for such marginalised groups.

Agro-based rural industries and craft-based cottage industries can really catapult local communities to socio-economic success stories. Local governments do their bit in developing these entrepreneurship clusters with a view to encouraging inter-firm collaboration and development of common facilities. entitled, 'Entrepreneurship Clusters in India.'

In regard to the development of entrepreneurship for impacting local communities, some corporate-sector initiatives also deserve a mention. ITC through their 'e-Chaupal' (visit http:/ www.itcportal.com agri_exports/ e-choupal_new.htm) and HLL through their 'Shakti' (visit www.hllshakti.com) initiatives have sought to mobilise native entrepreneurs for improving the lot of those lying at the bottom of the economic pyramid.

8. Fostering the Spirit of Exploration, Experimentation and Daring: Economic development, among other things, requires breaking away from the shackles of traditions and beliefs that restrict growth. For example if 'crossing the seas' were a taboo, there would not have been international trade and the resultant economic growth.

Indian Small and Medium Enterprises (SME) Clusters

With a contribution of 40% to the country's industrial output and 35% to direct exports, the Small-Scale Industry (SSI) sector has achieved significant milestones for the industrial development of India. Within the SSI sector, an important role is played by the numerous clusters that have been in existence for decades and sometimes even for centuries. According to a United Nations Industrial Development Organisation (UNIDO), there are 388 SSI clusters having 4,90,000 enterprises, employing 7.5 million persons with an output of Rs. 160,000 crore p.a. The number. of entrepreneurs in these clusters has been growing @ 15-18% p.a. over the last ten years. Besides, there are approximately 2000 rural and artisan based clusters in India.

Some Indian SSE clusters are so big that they account for 90 per cent of India's total production output in selected products. As for example, the knitwear cluster of Ludhiana and Hosiery cluster in Tripur in Tamil Nadu. Almost the entire Gems and Jewellery exports are from the clusters of Surat and Mumbai. Similarly, the clusters of Chennai, Agra and Kolkata are well known for leather and leather products.

However, the majority of Indian clusters, especially in the handicrafts sector, are very small with no more than hundred workers, so specialised that no other place in the world matches their skills and the quality of their output. This is the case, for example, of the Paithani sarees cluster in Maharashtra. However, only a tiny minority of such artisan clusters are globally competitive.

The formidable challenges created for the SSE sector by the liberalisation of the Indian economy, as well as its closer integration within the global economy, have generated a great deal of interest within India on novel approaches to SSE development. As a result, both private and public sector institutions at the Central as well as the State levels are increasingly undertaking cluster development initiatives.

Source: www.smallindustryindia.com

The established ways of life need to be challenged and change must be seen as an opportunity to improve rather than something to be scared of. Entrepreneurs, through their urge to do something new, seeing change as an opportunity, experimenting with the novel ideas and showing the courage to try them prepare a fertile ground for persistent economic development. Have you seen the Hindi movie 'Lagaan,' where the protagonist Bhuvan raises a cricket team from the villagers who had not even seen the game? Don't the feats of Karasn Bhai of 'Nirma' who challenged 'Surf' from the mighty Hindustan Lever Limited make you proud of the daring of the entrepreneurs?

Thus, whether one looks at economic development narrowly in terms of the increase in GDP or in the wider context of economic, institutional and social change, entrepreneurship plays a crucial role. Global Entrepreneurship Monitor studies report a lag of 1-2 years between entrepreneurial activity and economic development, suggesting that it takes time for the impact of entrepreneurship on economic development.

An important observation needs be made here. While entrepreneurship leads to economic development, the vice-versa is also true. That is, economic development also fosters entrepreneurship development. Growing economies provide a fertile soil for the flourishing of entrepreneurship, an aspect that we will take up while discussing entrepreneurship development.

Role of Entrepreneurs in Relation to their Enterprise

Drawing an analogy from musicology in explaining the role of the entrepreneurs in relation to their enterprise, one may say that an entrepreneur is not only the composer of the musical score and the conductor of orchestra but also a one man band. His roles and functions get much broader in scope in a developing country context like ours. entitled 'Role and Functions of the Entrepreneur in Relation to his/her enterprise.'

These elements are no sequential as the figure may convey, the entrepreneur may have to address to all these elements simultaneously. Yet, depending upon their backgrounds, the individual entrepreneur may prefer one over the other. For example, technicians tend to be over obsessed with the production aspect; those with marketing background may over emphasise creation of market. Investor type entrepreneurs may be over concerned with the returns from the project. One should resist the temptation of looking at the business only from one's own narrow perspective. Having said this, it is apt that we provide a brief description of the various issues that may be relevant at each stage.

Opportunity Scouting: Entrepreneurial opportunities have to be actively searched for. One may rely on personal observation, discovery or invention. Personal/professional contacts/networks and experience or may also help in identifying business opportunities. Alternatively, one may rely on published reports, surveys and the like. Narayan Reddy of Virchow Laboratories relied on the personal discovery of the molecule during his employment with a pharmaceutical company. As observation means seeing/hearing/smelling with a purpose, opportunity spotting presupposes tendency to look at the things and phenomenon from an entrepreneurial mindset. Most of us have a consumer's mindset. If we see any object of desire, may be a pen, laptop, latest model of the mobile phone or somebody eating pizza or burger, we crave to have the same thing for ourselves. The entrepreneurial mind, on the other hand starts working out, what would be the market size, where to procure it from and at what price, will I able to woo the customers from the existing

Roles and Functions of the Entrepreneur in relation the Enterprise

Developing Exchange Relationships

1. Perceiving market opportunities
2. Gaining command over scarce resources
3. Purchasing inputs
4. Marketing of Products and responding to competition

Political Administration

5. Dealing with public bureaucracy (approvals, concessions, taxes)
6. Managing human relations within the firm
7. Managing customer and supplier relations.

Management Control

8. Managing finance
9. Managing production

Technology

10. Acquiring and overseeing assembly of the factory
11. Industrial engineering (minimising inputs with a given production process)
12. Upgrading the production process and product quality
13. Introducing new production techniques and products.

Note: The scope of the entrepreneurial functions varies with the level of economy in which the entrepreneur operates; scale of production/operations; and entrepreneurs' comparative efficiency in utilising managerial employees. In developed countries, entrepreneurship assumes upon themselves the responsibility of introducing innovations and after some time, pave way for the managers. In large-scale organisations, entrepreneurs provide leadership and there is a team of managers to look after specific aspects of enterprise. Likewise, those entrepreneurs who have the ability and willingness to delegate may concentrate on a select few, strategic aspects of enterprise.

In terms of the process of setting up a business, therefore, an entrepreneur is on the look out for and spots the business opportunity, assesses its value, develops it in the form of a product/service idea, assembles he resources and gets going.

Source: Peter Kilby, (ed.), Entrepreneurship and Economic Development,? New York: The Free Press, 1971.

Resource mobilisation

↓

Scanning the environment for entrepreneurial opportunities

↓

Development of product/service idea

↓

Assessment of feasibility of the idea and preparation of a business plan

↓

Appraisal by the funding agencies

↓

Project Commissioning and launch

↓

Adaptation and management of growth

Process of Setting up a Business

players and how– by selling it cheaper, by providing more value or by better service and so on.

Entrepreneurial opportunities may also be identified through a process of research of international, domestic, sectoral/ industrial analysis.

For example, post WTO, international trade and investment have become freer of restrictions. Textile quotas are being phased out, and, there are greater opportunities for textile and textile made-ups from India. Global outsourcing is on the rise and India offers a huge and varied pool of technical manpower that makes it a cost effective destination for in-bound global outsourcing in manufacturing as well as Information Technology Enabled Services (ITES).

Identification of Specific Product Offering: While the environment scan leads to the discovery of more generalised business opportunities, there is a need to zero in on to a specific product or service idea. For example, trade liberalisation since WTOs has resulted in export opportunities, but the question is what to export and where? You may be required to compile a country-product matrix to be able to decide. (See proforma)

This way you may arrive at the product-market combination showing the fastest growing import and from your point of view export potential.

Deciding on the product offering makes the highest demand on the entrepreneur's creativity and innovativeness. Yet, in a competitive environment, it is possible to differentiate your product offering even if the generic product is the same and serves the same need.

Clearly decision on specific product offering necessitates decisions on who is buying, why, and what are the value expectations. You will be able to succeed when the value delivered not only meets but also exceeds customers' expectations and create a 'Vow!' impact.

Feasibility Analysis: The product offering idea must be technically feasible, that is it should be possible with the available technology to convert the idea into a reality. And this should be possible at a cost that can be covered by the price it will fetch; in other words, the idea must be economically feasible too. The project cost should be within the resources available and the resource providers should be reasonably sure of an appropriate return on (profit) and return of (safety and liquidity) of their investments. That is, the idea must be financially viable as well. There should be enough sales in the immediate and the prospect of growth in the foreseeable future; there should be adequate assurance on the commercial viability of the chosen product offering. Now a day, it is also important to be sure that there aren't any environmental and other legal restrictions/necessity of prior approvals for setting up the business. It is also to be decided as to whether the business will be organised as a proprietary concern/partnership firm/company or cooperative entity.

Clearly the chosen product offering must be feasible from the diverse perspectives. You must compile these findings in the form of a business plan that would have to be submitted to the funding authorities, in the Indian context, the State Finance Corporation of your area. They may be having a prescribed proforma in which the details of the business plan are required to be furnished and, as such there may a need to adapt the contents accordingly. An idea about the generic contents of a business plan may be had from.

The business plan may be appraised by the funding institution, and upon satisfying itself about the desirability of assisting your project and upon the furnishing of some margin money it may sanction the loan

International Environment → State of the Domestic Economy → State of the Sector/Industry

IDS Analysis for Entrepreneurial Opportunities

Products	Countries																								
	A					B					C					D					E				
	Import Statistics for Immediately Preceding Years																								
	1	2	3	4	5	1	2	3	4	5	1	2	3	4	5	1	2	3	4	5	1	2	3	4	5
X1																									
X2																									
X3																									
X4																									
X5																									

Proforma Country-Product Matrix

amount. Recall, Narayan Reddy and his two other associates provided Rs. 8 lakhs and the APSFC contributed Rs. 20 lakhs toward the overall project cost of Rs. 28 lakhs. Upon the project approval, the entrepreneur can proceed for project commissioning, that is putting up the factory premises, installing the equipment, obtaining the supplies of the input materials with a view to starting the manufacture and marketing the product.

As noted earlier too, entrepreneurial functions do not come to an end with the business start-up. He often looks after its day-to-day operations and strives for its stability and growth.

Entrepreneurial roles and functions clearly seem onerous. Perhaps that is why many shy away

Need of the Customer	Generic Product	Examples of Differentiating Specific Offering
Food	Burger	• Size • Zero Waiting time • Dine- in/Carry Away Delivery • Add-ons e.g., Beverage/ Chips or No-frills • Choice of Fried/Grilled • Customisation of topping, choice of ingredients

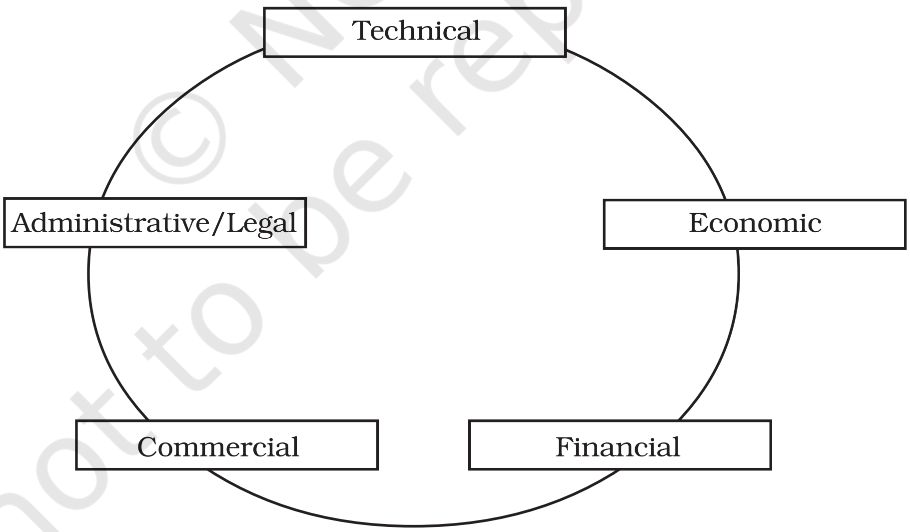
Product Differentiation

to simpler, softer and safer options of employment and practice of profession. Entrepreneurial going may be tough; but then that is where the tough get going! Do not worry if presently you may find yourself short on those competencies, values and attitudes. It is just a matter of making up your mind for a career in entrepreneurship and grooming yourselves for it. This takes us to the discussion of the process of entrepreneurship development.

The Process of Entrepreneurship Development

Entrepreneurship does not emerge spontaneously. Rather it is the outcome of a dynamic process of interaction between the person and the environment. Ultimately the choice of entrepreneurship as a career lies with the individual, yet he must see it as a desirable as well as a feasible option. In this regard, it becomes imperative to look at both the factors in the environment as well as the factors in the individual as having a nearing on the perception of desirability and feasibility and thereby entrepreneurship development. One may, therefore, model the process of entrepreneurship development in terms.

In general, capitalist economy with its emphasis on individual achievement is more suitable for entrepreneurship. Lower rates of taxation on personal income, lower rates of interest and moderate inflation stimulate



Aspects of Feasibility Analysis

entrepreneurial activity. (Can you think why it is so?) Moderately low external value of domestic currency or in other words, moderately lower exchange rates, stimulate import substituting and export promoting entrepreneurship. (Can you rationalise why?). Well developed financial system, good infrastructure, helpful bureaucracy all these have a favourable impact on entrepreneurship. Specially designed and dedicated institutions such as National Institute for Entrepreneurship and Small Business Development (visit, niesbud.nic.in), Entrepreneurship Development Institute of India (visit, www.ediindia.org) that conduct entrepreneurship awareness and entrepreneurship development programmes (EAPs and EDPs) a further fillip to this activity.

An important enabler or disabler of entrepreneurship is the prevailing socio-cultural milieu. Those societies that respect individual freedom to choose among occupations, that encourage the spirit of enquiry, exploration and experimentation, celebrate individual accomplishment and in general accord important status to the entrepreneurs are likely to have self-sustaining supply of able and willing men and women for taking to entrepreneurship as a career.

The Role of the Individual in Entrepreneurship Development

Mr. Narayan Reddy was desirous of starting a small scale industry and also had a sense of efficacy or readiness to pursue it given his qualifications,

Business Plan

1. Executive Summary
2. Business/industry background
3. Product/service to be offered
4. Market analysis
5. Sales and marketing strategy
6. Production/operations strategy
7. Management
8. Risk factors
9. Funds required
10. Return on and off investment and exit routes
11. Use of the sales proceeds
12. Financial summaries
13. Appendices, e.g., Reports on Market Survey, Financial Statements, Track Record etc.

experience and the necessary values, attitudes and motivation (the opening case does not elaborate this. We will discuss these at suitable places). Even you may like to see as to where do you find yourself on the desirability (willingness)-efficacy (ability) matrix, won't you?

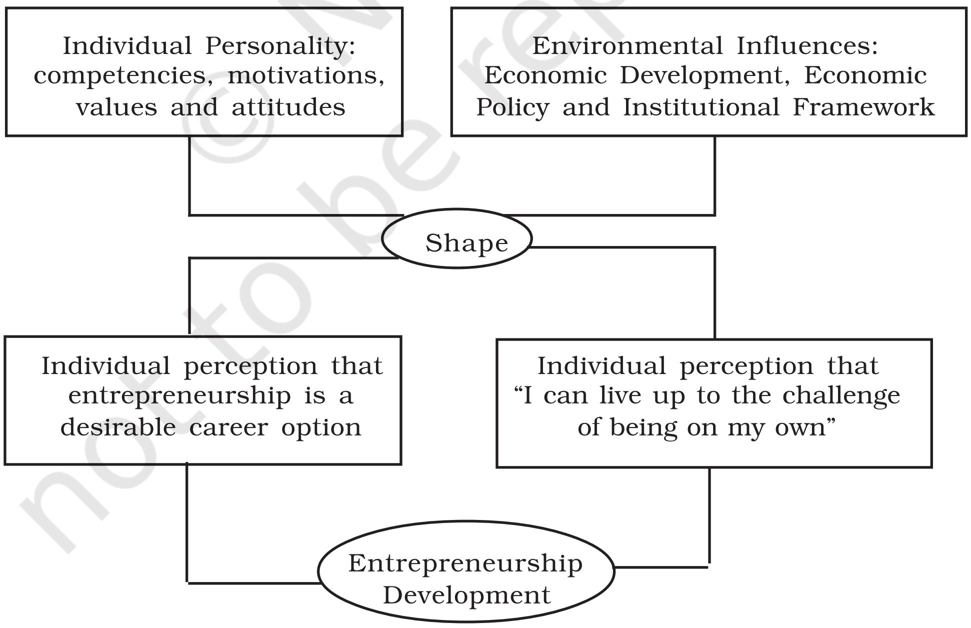
As you may see from the matrix figure able and willing men and women are a "ready" source of entrepreneurship. Such persons leap up the first opportunity comes their way to be on their own. Recall, Narayan Reddy leapt up the opportunity as he met the two medicos who had returned from the Gulf.

At any point of time, there are many men and women who "want" to set up a business of their own but experience self-perceived barriers to entrepreneurship. They could be having a low perception of self-efficacy either on account of lack of resources (or to be more correct, resourcefulness), knowledge or know-how, and the skills. Collectively, these are referred to as competencies, which now we turn our attention to.

ENTREPRENEURIAL COMPETENCIES

Every opportunity and successful performance of every role and function has a competence requirement. Its true of entrepre-neurship as well. entitled 'Cash OR KASH?'

The term 'competence' refers to a composite of knowledge, skills and a host of psychosocial attributes (including Attitudes and Motivation that



The Role of Environment in Entrepreneurship Development

Entrepreneurs bring about economic growth and development, and the latter in turn provides a fertile soil for the flourishing of entrepreneurship. There certainly is a mutually facilitating reciprocity between economic growth and entrepreneurship development.

we will be discussing separately) in a person that mark his/her effectiveness for a task. The phrase 'composite' is crucial. For example, the competence "ability to communicate vision" is much more than proficiency in writing/ speaking skills. It would involve, just to illustrate, vision clarity, understanding the audience background, interest and readiness, knowledge about the media and choosing the most appropriate one, attracting attention, delivery, leaving not merely an impression but also an impact and, assessing effectiveness. So, when the entrepreneur in the television interview pointed out KASH as the determinants of successful entrepreneurship, he was indeed referring to the competencies.

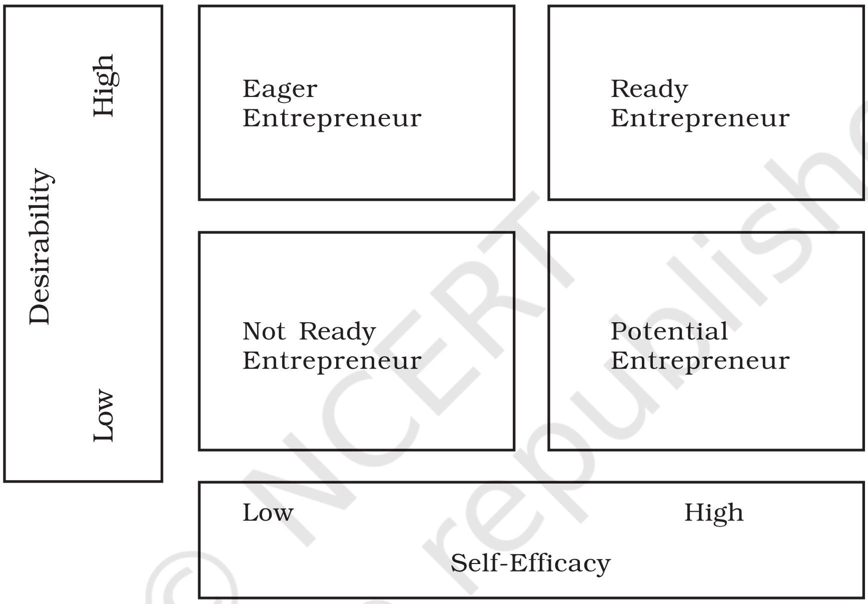
Competency approach to human resource development in general and entrepreneurship development in particular was pioneered by David McClelland, a Harvard University psychologist in the late 1960's and early 1970's. (You will be learning more on McClelland's work when we discuss entrepreneurial motivation.) McClelland set out to define competency variables that could be used in predicting job performance and that were not biased by race, gender, or socio-economic factors. As a result, it becomes more important to learn what a person does rather than who he/she is. That is why management and also entrepreneurship is better defined as what a manager or an entrepreneur does. Because competencies can be built via a process of education and development, we may say that entrepreneurs are made.

What are the distinct competencies for entrepreneurship? In this regard one may refer to the efforts of Entrepreneurship Development Institute of India (EDI), a national resource institution in the area of entrepreneurship education research and development (visit, www.ediindia.org).

EDI has identified a set of 15 competencies that contribute toward entrepreneurial performance and success. These are briefly stated hereunder.

Initiative: Acting out of choice rather than compulsion, taking the lead rather than waiting for others to start.

Sees and Acts on Opportunities: A mindset where one is trained to look for business opportunities from everyday experiences. Recall 'oranges' example.



Efficacy-Desirability Matrix

Persistence: A 'never say die' attitude, not giving up easily, striving continuously until success is achieved.

Information seeking: Knowing and knowing who knows, consulting experts, reading relevant material and an overall openness to ideas and information.

Concern for High Quality of Work: Attention to details and observance of established standards and norms.

Commitment to Work Contract: Taking personal pains to complete a task as scheduled.

Efficiency Orientation: Concern for conservation of time, money and effort.

Systematic Planning: Breaking up the complex whole into parts, close examination of the parts and inferring about the whole; e.g. simultaneously attending to production, marketing and financial aspects (parts) of the overall business strategy (the whole).

Problem-solving: Observing the symptoms, diagnosing and curing.

Self-confidence: Not being afraid of the risks associated with business and relying on one's capabilities to successfully manage these.

Assertiveness: Conveying emphatically one's vision and convincing others of its value.

Cash or KASH

"What do you need to be a business person?" was the opening question the anchor of a television interview asked an eminent business personality. "Caash" she heard and though that her interview is going to be a spoil, for it was an answer so obvious and exhaustive that there was not anything else to talk. Or this is what she thought.

The entrepreneur saved her day, "young lady," he continued, "you seem to have got it wrong!" "What I meant was not C_a_s_h_=Cash, but K_A_S_H= KASH!"

Interview was off to a flying start! And the interviewee went on to elaborate what he meant, K=Knowledge, A=Attitude, S=Skills and H=Habits.

Persuasion: Eliciting support of others in the venture.

Use of Influence Strategies: Providing leadership.

Monitoring: Ensuring the progress of the venture as planned.

Concern for Employee Welfare: Believing in employee well being as the key to competitiveness and success and initiating programmes of employee welfare.

You would, now, be interested in knowing as to how to build these competencies. Knowledge competencies (what you know regarding facts, technologies, a profession, procedures, a job, an organisation, etc.) can be developed by, for example by reading and interacting with people who know. Skill competencies (what you say or do that results in good or poor performance) can be acquired by practice, haven't you heard "practice

makes a man perfect"? For example, 'persuasion,' and 'use of influence strategies' require presentation skills. You may do double the homework on what you want to say, how you want to say, who is your audience and what are their backgrounds, what could be the possible questions that may be asked, what would be their answers and so on. Practice it all over a number of times, may be before mirror or your friends, so that when you are actually in that situation, you perform well.

Entrepreneurial Motivation

Men and women who have a perception of self-efficacy and are yet to feel interested in or motivated by the idea of being on their own comprise a potential, future source of entrepreneurship. What motivates a person is a question easier asked than answered. Mr. Narayan Reddy was driven by the desire to utilise his discovery of the molecule as a business opportunity. In terms of Maslow's need hierarchy theory, one may say that Mr. Narayan Reddy was driven by the need for self-actualisation. Since entrepreneurial situation is characterised by personal accomplishment in competitive situations and involving higher standards of excellence, one often come across reference to 'need for achievement' or N-ach for short as the primary driver of entrepreneurial behaviour. See Box entitled 'How N-Ach. Drives Entrepreneurship and Economic Development'.

Need for Achievement (N-Ach.): Need for achievement implies a desire to accomplish something difficult. To master, manipulate, or organise physical objects, human beings or ideas. To do this as rapidly and as independently as possible. To overcome obstacles and attain a high standard. To excel one's self. To rival and surpass others. To increase self–regard by successful exercise of talent. Yes entrepreneurship provides you with the best opportunity for making the best use of your talents as in employment the 9-5 routine, pressure to adhere to rules and regulations, preference for compliance of boss's instructions over the use of personal creativity and innovativeness stifles your progress and self-development. You can create a work environment that suits your abilities and interests.

Need for Power (N-Pow): Need for Power is the concern for influencing people or the behaviour of others for moving in the chosen direction and attaining the envisioned objectives. In common perception, politicians, social-religious leaders Chief Executive Officers (CEOs), Government Bureaucrats/Civil Servants typify the need for power. Such a perception seems more based on the belief that the source of power lies in the "position" a person occupies in organisational/societal context. In the same vein, business ownership too may imply a need for power. Moreover, you would appreciate that the process of founding a business, one has to win the commitment of capital providers, suppliers of equipment and materials, the employees and that of the customers. Power may not be used to further one's self- interests alone, it may be also be used to touch the lives of others, to make a difference. Entrepreneurs driven by this socialised face of the need for power. They found organisations that are a source of sustenance and self- respect for many.

How N-Ach. Drives Economic and Entrepreneurship Development

Credit for investigating and bringing to the fore the role of need for achievement goes to McClelland, the Harvard professor whom we referred to also in the discussion of competency based approach to human resource and entrepreneurship development. He set out to investigate why some countries are more developed than others He sought to find answer to this question by examining the proposition that 'differences in the level of achievement motivation are responsible for 'differences in the level of economic development'. For this he examined the popular stories and folklore and readers up to primary classes of 39 countries for finding out whether they focused on personal accomplishment, triumph of human courage and effort over the circumstances and so on. McClelland's research upheld the proposition that differences in the levels of achievement motivation as revealed by the analysis of the stories and the readers accounted for the differences in the level of economic development. How? What would be the process? McClelland observed that entrepreneurship becomes the medium through which the achievement motivation manifests the best and through which the development takes off.

Need for Affiliation (N-Aff.): Often you must have heard your parents saying that whatever they do they do it for their children. If a man thinks about interpersonal relationships, he has a concern for affiliation. It implies, among other things a tendency of the people to conform to the wishes and norms of those whom they value. Apparently, social activists, environmentalists, teachers, and doctors and nurses may seem as predominantly driven by these needs. Entrepreneurs are believed to be low on affiliation, as they are and expected to be, innovative, trendsetters and tradition breakers. However, it is not necessary that affiliation should only interfere with achievement. In certain cultures, family comprises the bedrock on which the successful careers are built. One works, as if, not for personal gratification but for family. Desire to carry on the tradition of business in the family and the community to which one belongs, may be interpreted as reflecting need for affiliation as well. In the countries with the colonial past, such as ours, the first generation of entrepreneurs in Independent India was driven by patriotic fervor and the desire to rebuild the economy left stagnated by the alien rulers. One can certainly trace some elements of affiliation motivation in such instances.

Need for Autonomy (N-Aut.): The need for autonomy is a desire for independence and being responsible and accountable to oneself rather than some external authority for performance. It is the desire for an opportunity for the fullest expression of one's abilities. In the context of entrepreneurship, it is usually interpreted as the determination not to work for someone else. In most job situations, employees are given little freedom to exercise their discretion in taking decisions and choosing a course of action so much so that absence of it drives them into starting their own ventures. As such n-pow. becomes more a desire for preserving one's ethos rather than the freedom from the boss. Take the example of another Hyderabad based entrepreneur entitled Entrepreneurship for Preserving Personal Work Ethos).

What does the above discussion mean for entrepreneurship development? It means that for promoting entrepreneurship it is important to kindle and arouse the right motivation. In the absence of motivation, even able men and women may not take to entrepreneurship. Hence. In every Entrepreneurship Awareness Programme (EAP) or Entrepreneurship Development Programme (EDP), there are special sessions on entrepreneurial motivation, besides sessions on entrepreneurial competencies.

You may note that motivation and ability can positively reinforce each other. Persons having abilities search for the avenues for their expression and hence are drawn to entrepreneurship. Persons eager to be on their own may strive hard to acquire the necessary competencies to realise their dreams. How truly one has said that entrepreneurs are the dreamers who do!

In explaining and developing entrepreneurial motivation, it is important to learn that different individuals are motivated differently, and that one may be trying to satisfy more than one need through one's pursuit. This is an important observation as economic theory very simply says that the objective of the firm or that of the entrepreneur is profit maximisation.

Entrepreneurial Values and Attitudes

While explaining human behaviour, one often comes across the terms values and attitudes. Rather than attempting to distinguish between these two terms, it would be sufficient to say here that taken together, entrepreneurial values and attitudes refer to the behavioural choices individuals make for success in entrepreneurship. The word 'choice' is important, as there are alternative ways of behaving too. In entrepreneurship, a host of behavioural tendencies or orientations have been reported as having a bearing on success. The entrepreneur in 'Cash or KASH' labeled these as 'Habits', some researches have called these as policies or strategies. Be it the decision to make a choice about entrepreneurship as a career, be it the decision to choose the product line, growth strategy, profit making and social responsibility you would be required to make choices. The choice that you make may have a tremendous impact on your performance. What we do here is to profile some of the dimensions relating to starting and managing a business and the associated behavioural alternatives, we have considered here *two* to keep the things simple. We have highlighted those alternatives that have been generally observed to be associated with superior performance.

Entrepreneurship for Preserving Personal Work Ethos

In industries having captive power plants, a day's downtime can cause a loss of crores of rupees. While working for a public sector electrical major, an engineer found it really difficult to cope with the bureaucratic attitude in servicing the customers. It clashed with his personal value, 'client's problems be attended first, paperwork can wait'. He quit the job and started a turbine repairing and furbishing company. Incidentally, it takes more money to travel or to transport than to repair or refurbish the turbine. But the downtime is reduced and the clients are happy. Later the company also diversified into the manufacture of the parts and commissioning of the captive power plants on a turnkey basis.

Behavioural Choices for Entrepreneurial Success

S. No.	Dimensions	Behavioural Alternatives
1.	Type of Entrepreneurship	Choose pioneering/innovative products Choose tried and tested products
2.	Business Decision	Choose business as per qualifications/experience Grab whatever opportunity comes your way
3.	HRM: Recruitment Policy	Recruit trustworthy, dependable and obedient employees Recruit qualified and trained professionals
4.	Managing Growth: Pace	Grow only at/to manageable pace/extent Make a hay while the sun shines
5.	Organising: Ability to Delegate	Supervise closely Delegate and decentralise
6.	Marketing Management: Marketing Concept	Sell hard what you produce Produce according to customers' requirements
7.	HRM: Compensation	Reward good performance by additional increments/promotions Reward just as you please
9.	Managing Growth: Direction	Grow around core-competence Grab whatever opportunity comes your way
10.	Marketing Management: Product Planning and Development	Change the product only if absolutely necessary Innovate/improvise continually
11.	Operations Management: Locational Decision	Locate the business near social contacts Locate purely on economic merits
12.	Operations Management: Cost Rationalisation	Increase profit by negotiating hard with suppliers, workers and customers Reduce cost by cutting the overheads and improved efficiency
13.	Managing Competition	Fight the competition Avoid competition
14.	Planning: Approach to Decision-making	Scan the environment for business information Rely on intuition/judgment
15.	Organising: Formalisation	Do everything by yourself Appoint specialists and professionalise the systems
16.	Ethics	Never compromise on business ethics Everything is fair in love, war and business
17.	Succession Planning	Plan and train a successor Business will find a successor
18.	Planning: Time Horizon	Have a long term perspective Live your business day-by-day
19.	Operations Management: Research and Development	Invest in R and D R and D is an ill-affordable luxury

KEY TERMS

Entrepreneurship	Enterprise
Entrepreneurial Risks	Experimentation
Exploration	Rural Entrepreneurship
Entrepreneurial Opportunities	Entrepreneurial Competencies

SUMMARY

The terms 'entrepreneur,' 'entrepreneurship' and 'enterprise' can be understood by drawing an analogy with the structure of a sentence in English language. Entrepreneur is the person (the subject), entrepreneurship is the process (the verb) and enterprise is the creation of the person and the output of the process (the object).

Entrepreneurs play important roles both in relation to economic development and in relation to the enterprise. In relation to economic development, entrepreneurs contribute to growth in GDP, capital formation and employment generation besides creating business opportunities for others and bringing about an improvement in the quality of life in the community in which they operate. In relation to the enterprise, they perform a number of roles right from the conception of a business idea, examining its feasibility and mobilisation of resources for its eventual realisation as a business firm. They bear the uncertainties and risks associated with the business activity, introduce product, market, technological and a host of other innovations. In the developing country context they also assume the responsibility for the day-to-day management of the enterprise.

Given its critical role in economic development at a broader level and business start-ups at the micro level, it is imperative that a conscious effort be made to popularise entrepreneurship as a career option. In this regard, EAPs and EDPs can play an important role. Besides, there is a need to create an entrepreneurship friendly environment. Since, entrepreneurship is the outcome of a dynamic interaction between the person and the environment, there is need also for developing entrepreneurial competencies, motivations, values and attitudes.

EXERCISES

Multiple choice questions

Put a tick (✓) against the most appropriate answer to the following questions.

1. Entrepreneurs undertake
   a. Calculated risks
   b. High risks

c. Low risks

d. Moderate and calculated risks

2. In economics, which of the following is not a function of the entrepreneur?

a. Risk-taking

b. Provision of capital and organisation of production

c. Innovation

d. Day to day conduct of business

3. Which of the following statements does not clearly distinguish between entrepreneurship and management?

a. Entrepreneurs found the business; managers operate it

b. Entrepreneurs are the owners of their businesses; managers are employees

c. Entrepreneurs earn profits; managers earn salaries

d. Entrepreneurship is once for all activity; management is a continuous activity

4. In the roles and functions of the entrepreneur identified by Kilby, which of the following is not an aspect of 'political administration'?

a. Dealing with public bureaucracy

b. Managing human relations within the firm

c. Introducing new production techniques and products

d. Managing customer and supplier relations

5. Which of the following attitudes is not generally associated with successful entrepreneurship

a. Investing in R and D

b. Live your business day by day

c. Innovate and improvise continually

d. Produce as per customers' requirements

Short answer questions

1. Clarify the meaning of the terms 'entrepreneur,' 'entrepreneurship,' and 'enterprise.'
2. Why is entrepreneurship regarded as a creative activity?
3. "Entrepreneurs undertake 'moderate' risks." Elaborate this statement.
4. How does entrepreneurship result in increasing the spectrum and scope of economic activities?

5. Describe briefly the role of achievement motivation in entrepreneurship.

Long answer questions

1. Describe briefly the steps involved in starting a new business.
2. Examine the nature of relationship between entrepreneurship and economic development.
3. Clarify how motivation and abilities impact an individual's decision to choose entrepreneurship as a career.

Application question

Anshuman was a very industrious sales executive with a small herbal cosmetic manufacturer. He earned a good salary and commission on the business he brought for the firm and had very good command over the Delhi market for which he had virtually become indispensable. He was aware of the enviable position he held in the firm and thought aloud:

"The key to success in any business is the sale of its products. The beginning and end of the business cycle is nothing but sale and "other" people working in the factory to manufacture products are mere cogs in the business machine set in motion by sales people. So why carry this burden and get only a tiny share of the prosperity of the firm? Instead others enjoying the fruits of my labour, why should I not start my own business?"

Should Anshuman take a leap? Give reasons for your answer.

Case Problem

Inspiring Feat: Dailywage Labourer Turns Entrepreneur

A landless woman from Bihar has been nominated among the top 25 farmers in Asia by a Mexican website.

Forty-five-year old Lalmuni Devi was a daily wage labourer when she decided to take destiny into her own hands and transformed herself into a successful mushroom farmer. Today she manages to make Rs. 12,000 every year for an investment of only Rs. 600.

Her feat finds mention on a Mexican website that has grouped her as the top 25 inspirational farmers in its photo gallery.

"I am a poor woman. I thought that mushroom farming would profit henceforth I started it. Now I can earn a living for my family," said Lalmuni Devi.

Successful enterprise

The success story has caught on with many women in the Azadpur village on the outskirts of Patna.

”It is effortless farming, which we can even do in our village. Working in the scorching heat is very tiring. Mushroom farming generates more profit,” said Urmila Devi.

Lalmuni and other landless women have been encouraged by the Indian Council for Agriculture Research to take up mushroom farming.

”It is to help the poorest of the poor through alternative livelihood support system. For that we have chosen a village where people have no land and they have to share croppers,” said Dr A.R. Khan, Principal Scientist, ICAR, Patna.

Lalmuni’s efforts have paved the way for many other landless women to take up mushroom farming and earn a livelihood for their family with little effort.

Source: - www.ndtv.com/features downloaded on 15/3/2006 at 1.35 am

Question

1. What inspiring feat did Lalmuni Devi perform?
2. Do you feel that you can also become an entrepreneur? Elaborate.
3. What qualities of an entrepreneur did Lalmuni Devi exhibit?
4. What are the benefits and risks of becoming an entrepreneur? How can you guard against the risks?

   (Teachers should highlight the qualities of an entrepreneur and motivate students to do so. Help that is available from the government of India is listed on the website *www.india.gov.in*.).

Project Work

1. Visit a newly started small business in your neighbourhood and interview the owner. Prepare a report on how he/she decided to start the enterprise and the difficulties he/she faced. Also include steps taken by the owner to overcome them. Discuss the findings in the class.
2. Study the life history of great entrepreneurs, such as Dhirubai Ambani, Jamshedji Tata, G.D.Birla or Kiran Mazumdar Shaw etc. Prepare a list of common traits of these people and discuss them in your class. Can you imbibe some of these qualities and start some enterprise later on in life?

NOTES